REPORT ON THE TAXATION OF NORTHERN ALLOWANCES

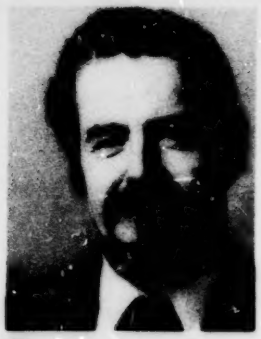
R.M.Bird, N.E.Slack
August, 1983

85-1766/

Report on the Taxation of Northern Allowances

by
R. M. Bird
and
N. E. Slack

August 1983
ISBN 0-7708-2011



Foreword

It is with pleasure that I am able to present this independent report on the taxation of northern allowances.

The report was prepared, at my request, by international tax policy analyst Professor Richard M. Bird of the University of Toronto and his associate N. E. Slack.

Professor Bird concludes that the proposed federal government regime on the taxation of northern allowances will create more inequities amongst northern taxpayers than already exist.

Among other things, the report notes Ottawa's tax proposal does nothing to address North/South cost of living differences and establishes a system where it will be more attractive, tax wise, to provide bunk house types of accommodation — and in doing so encourage the continuation of a transitory population.

Professor Bird's report, now in the hands of Federal Minister of Finance Marc Lalonde and his officials, recommends introduction of a system that would apply to all northern residents regardless of whether or not they receive employee benefits.

Northern taxpayers receiving benefits would have their taxable incomes increased by the addition of the allowances but would also have their personal exemptions increased by application of an indexing factor.

Taxpayers not receiving benefits would receive the increased exemptions.

In recognition of cost of living differences within the North, the report further recommends a two tax-zone concept that would see an increase of 25 per cent in personal exemptions for taxpayers in larger centres such as Yellowknife and a 50 per cent increase for taxpayers in more remote regions.

It is my hope that Mr. Lalonde and his officials will respond favourably to this report and its recommendations and that the response will result in a final solution to this outstanding matter — a solution that is fair and equitable to all northern taxpayers regardless of whether or not they receive employee allowances.

The Hon. Tom Butters
Minister of Finance

Contents

Page

Preface 5

I. Introduction 7

II. Background 9
A. Federal-Territorial Fiscal Arrangements 9
B. The December 1982 Proposal 11

III. Analysis of the Proposed New Tax Regime 13
A. Eliminating and Creating Differentials 13
B. Some Probable Impacts of the New Tax Regime 15

IV. Analysis of the Issues 18
A. The Taxation of Fringe Benefits 18
B. The Case for Regional Tax Differentials 19

V. Alternative Approaches 22
A. A Revised Proposal 22
B. Other Tax Approaches 23
C. Non-Tax Approaches 25

VI. Conclusion 27

Appendix A: Benefits Received by Employees of GNWT, 1982 28

Appendix B. Zone Allowances in Australia 29

Appendix C. Provincial Tax Credits 31

Statistical Appendix 33

Notes 44

Preface

This study was prepared at the request of Mr. Thomas Butters, Minister of Finance and Government Services of the Northwest Territories. The authors are most grateful for the considerable amount of help received from many people in Yellowknife, Ottawa, and elsewhere. They are especially grateful to Mr. Butters, Mr. Eric Nielsen, Deputy Minister of Finance, Phyllis Sartor, Executive Assistant to the Minister, the other GNWT officials who provided substantial information on the matters covered in this study, and to many others in both the private and public sectors in Yellowknife who gave freely of their time and ideas. Russell Mathews in Canberra, Greg Ballentine in Washington, and Sean Finn in Toronto also provided useful material. It must be emphasized, however, that the authors alone are entirely responsible for the contents of this study.

We took on this project because it looked both interesting and "do-able": it has indeed turned out to be interesting, both from the point of view of tax theory and from that of northern development, but it has unfortunately also turned out to be harder to do properly, particularly with respect to the quantitative dimension, than we had at first thought. Since our principal concern was to analyze this issue from a tax policy perspective, however, the relative lack of empirical evidence on some important matters in this study is perhaps not too grave a defect. In any case, despite the evident deficiencies of this study we think that the discussion of the taxation of northern allowances contained herein is probably the most thorough and wide-ranging yet prepared in Canada, and we hope it may serve as a useful starting point for the needed further discussion of appropriate policy in this area.

Richard M. Bird
N. Enid Slack

I. Introduction

The federal government has recently declared its intention to tax certain housing and travel benefits currently received by many employees in the northern territories (as well as certain other isolated posts). The impact of this tax change on employees and employers in the Northwest Territories (NWT) is expected by some to be significantly adverse. Many employers now provide substantial cash and non-cash benefits and allowances to their employees in order to offset the substantially higher cost of living in the North. One estimate is that over 15,000 employees in the NWT received some tax-free benefits in 1982 which will be subject to tax starting in 1984.[1] In the case of territorial government employees, for example, the average amount of these benefits was over $5,000.[2]

The majority of those affected by the proposed tax change work for government and for relatively large mining companies. As shown in Table 1 (in the Statistical Appendix) the largest employers are the mining, oil and gas companies followed by the territorial government and the federal government. In total, these three employers account for almost 70% of total employment in the territories. Since the amount of tax-free benefits now received varies from employer to employer, and from employee to employee, and since some employees in the NWT receive few or no tax-free benefits, the existing system of not taxing these allowances at all seems, on its face, unfair. As shown in this study, however, the particular way in which the federal government intends to subject some of these benefits to tax in fact introduces further inequities into the tax treatment of individuals in the North, and it is far from clear that the net result will be a significantly more equitable tax system.

There are four main sections in the present study. The first section provides some background necessary to the subsequent analysis. The general federal-territorial fiscal context in which the proposed new system of taxing benefits must be understood is briefly described first. An apparent principal aim of recent federal policy in the north has been to encourage the NWT to reduce the degree of its fiscal dependence on the federal government both by relying more heavily on its own income tax and by altering the form of federal transfers to the territory. An important aspect of the proposed taxation of employee benefits thus concerns its probable impact both on the NWT's potential future use of the personal income tax and, more generally, on federal-territorial fiscal arrangements. The second part of Section II of the study then briefly reviews the history of the northern tax allowance, culminating with a summary of the federal policy announced in December 1982.

The second main section of the study, Section III, is also divided into two parts. The first part analyzes the extent to which the proposed new system — via the differential treatment of cash and non-cash allowances, the location differential, the differential by housing type, and the travel provision — creates rather than eliminates differentials among individuals. It argues that there can be no presumption that the net result is necessarily much more equitable than the present inequitable situation. The second part of this section then considers briefly some possible impacts of the new tax treatment on employers, employees, migration, homeownership, and on northern development in general. These arguments are not developed at length in this study, however, because its major aim and purpose is to analyze the new system of taxing benefits from a strictly "tax policy" perspective since that is allegedly its major rationale.

Section IV,is in a sense the core of the present study from this perspective since it first analyzes the "fringe benefit" issue and then provides a conceptual framework for analyzing the tax treatment of individuals living in isolated areas where the cost of

living is significantly higher than elsewhere. It turns out, perhaps surprisingly, that based on both equity and efficiency arguments, a strong case can be made to allow tax differentials in different parts of the country: uniform ***results,*** in short, may require ***differential*** treatment. In other words, since the higher cost of living results in higher ***effective*** tax rates in the NWT, in order for residents of the NWT to enjoy the same standard of living as comparable southern counterparts it may be necessary to define the tax base differently. The political and administrative difficulties inherent in this conclusion are noted briefly, but the main emphasis in this section is on establishing the principle of regional differentials.

Finally, the last substantive section of the study, Section V, considers various ways of achieving the necessary differentials. The first part considers some improvements that may be possible — and would appear to be desirable — within the general framework of the December 1982 system. The second part then evaluates briefly a number of other tax approaches — spatial indexation, rate reductions, deductions, and tax credits. The final part of this section then reviews, even more briefly, several non-tax ways of recognizing the need for differential treatment of individuals who live in isolated areas, particularly through transfers, either provided directly to individuals and businesses or through the NWT government. As will be seen, the best type of transfer scheme depends ultimately upon the precise nature of the policy objectives that are to be achieved. The same is of course true of the tax alternatives discussed in this section.

Indeed, a principal conclusion emerging from this analysis is that the best approach to such difficult policy questions as those involved in the taxation of northern allowances depends very much upon the objectives of policy that are considered relevant. From this perspective, it seems clear that a major problem with the current federal scheme is that it is too narrowly focused on a partial, and debatable, view of the objectives of tax policy in the NWT. Even if the only objective considered were tax equity, however, and even if the general approach in the current scheme must in the end be accepted, the details should both be significantly modified in some respects and — at least as important — any tax changes must be accompanied by explicit adjustments in federal-territorial transfers if they are to accomplish the stated objective of establishing "fairness in taxation".[3]

II. Background

A. Federal-Territorial Fiscal Arrangements

The federal decision to tax northern allowances comes, rather paradoxically, at a time when federal policy appears to be urging the reduction of territorial fiscal dependence on the federal government, both by encouraging the Government of the Northwest Territories (GNWT) to rely more heavily on its own tax sources and by altering the formula for federal-territorial transfers. Recent developments in federal-territorial fiscal relations therefore constitute an important part of the northern reality within which the taxation of benefits must be considered.

In general, and perhaps not surprisingly, federal-territorial fiscal relations seem closer in spirit to the "father knows best" attitude prevalent in provincial-municipal relations than to the almost arm's length negotiations characterizing federal-provincial fiscal relations. So long as over 80 per cent of territorial revenues are derived in some way from the federal government, it is perhaps inevitable that almost every aspect of territorial fiscal decision-making is controlled, in greater or lesser degree, by the federal government.[4]

The current financial arrangements reflect, in part, the limited tax base of the territorial government. Since (as discussed further below) the effective ***federal*** tax rate on personal incomes is higher in the NWT than elsewhere in Canada, the GNWT has in a sense been restrained from imposing higher territorial tax rates than the basic rate in order to avoid "overtaxing" its residents relative to taxpayers elsewhere.[5] (The income tax in the NWT, as in most provinces, is set as a percentage of the federal tax payable.) To some extent, in other words, the federal income tax has "crowded out" the GNWT tax. One result is that territorial reliance on the personal income tax is relatively low and will likely continue to be low — unless, perhaps, some recognition is given to the above-average impact of federal taxes in the territories.

Since the proposal to tax benefits will, of course, increase income tax collections in the NWT, particularly federal collections, one consequence is that it is likely to further inhibit the territorial government from increasing its own tax rates. The effective federal tax rate in the NWT is already higher than in other parts of the country. Taxing northern benefits will make this rate even higher and will thus affect the territorial government's ability to raise its own income tax rate. Even taking into account the fact that the GNWT will also gain revenues, one unexpected effect of taxing northern benefits may thus be an undesirable impact on the long-run financial relationship of the NWT with the federal government. To the extent that an important federal objective is to reduce the territory's fiscal dependence on the federal government, it should be clearly understood that taxing northern benefits, whatever its other merits, will work against attainment of this goal.

Federal responsibility for the NWT has always included substantial financial responsibility.[6] The GNWT began to levy its own income tax — now its most important single source of own revenue — only in 1978, and it has always depended primarily on federal transfers. In 1952 a five-year financial agreement between the federal and the NWT governments was signed guaranteeing the GNWT an annual federal subsidy. The GNWT at the same time also took responsibility for expenditures out of its own revenue sources as well as out of subsidy revenues. Similar agreements were signed in 1957 and 1962. Between 1966 and 1976 there was a further gradual transfer of responsibilities from the federal government to the GNWT, with annual agreements providing grants for both operating and capital purposes. Direct federal transfers for such specific purposes as health and education are also provided, under arrangements similar to those ex-

isting for the provinces. Additional special purpose grants for roads and other facilities are also made.

The special status of the territory is particularly evident in the way many of its financial decisions are made. Operating and capital grants for the NWT appear in the estimates of the Department of Indian Affairs and Northern Development (DIAND), which means that federal transfers to the GNWT are evaluated (along with other DIAND expenditures) within the Social Affairs envelope. In short, the NWT is in effect treated as part of a federal government department as far as budget allocation decisions are concerned, rather than an independent level of government. Its expenditure priorities are thus compared to other DIAND expenditures and other ***federal*** priorities rather than evaluated within a local or regional context as is the case with provincial expenditures.

Decisions on the operating grant (also known as the "deficit" grant), for example, require the Treasury Board to review the GNWT operating budget in relative detail, with particular attention to changes in expenditure levels. The "deficit" grant that is finally established by this process makes up any difference between approved NWT expenditures and revenues. Basically, the federal and territorial governments come to agreement on some method of expenditure projections and then deduct projected revenues from the expenditure amount thus obtained to determine the net operating grant. Increases in the volume of services need to be substantiated, while price level increases are set in accordance with Treasury Board indexes. Similarly, the NWT capital grant is approved on an indexed year-to-year basis indexed by the construction price index (which may have little to do with conditions in the NWT). Additional approvals by the Treasury Board are required for projects over $1 million. Although the formal territorial role in the budgetary process has increased substantially in recent years, the end result is still that territorial priorities are decided largely within the context of broader federal priorities.

Although, as noted above, the NWT also receives EPF (Established Program Financing) funds for health and education, as do the provinces, this has little impact on overall funding because the operating grant is reduced concomitantly. The NWT does ***not,*** however, receive equalization transfers.

A proposal to institute formula financing is currently under review by the federal government.[7] The idea — which is of course subject to (federal) revision — is basically to establish, through intergovernmental agreement, a longer-term federal-territorial fiscal arrangement, thus providing more scope for financial planning than the current one-year arrangement. The new arrangement, however, would apparently still be based on expenditures: the grant might, more or less as in the present system, be a function of a known base level of expenditure (e.g., operating and capital expenditures for 1982-83) and an estimated growth rate (e.g., indexed to the provincial-local government expenditure growth pattern with, apparently, no allowance for possibly different movements in Northern costs). The formula payment would then be the difference between estimated revenues, recoveries and (other) transfer receipts and the calculated gross expenditure level. An important change from the present system, however, is that the formula payment would apparently not be reduced when tax rates were increased, with the result that there would be no disincentive to the GNWT to increase its own fiscal efforts. In contrast, with the current deficit grant, an increased territorial tax rate automatically means a reduced federal grant. This difference arises because in the proposed formula estimated revenues are based on the tax rates in effect in the ***base*** year rather than the rates actually prevailing.

Formula financing along these lines would obviously increase the degree of budgetary flexibility of the GNWT and would remove an obvious disincentive to territorial tax increases. It would, however, do nothing to alleviate the "crowding out" problem noted above (and developed further below). In any case, in view of the limited tax base of the NWT, its present high degree of dependence on federal funds — whether received through specific purpose grants or through formula financing — will undoubtedly continue to constitute its most important financial reality for years to come.

Table 2 contains a breakdown of GNWT revenues for 1981 and 1982. Own-source revenues made up only about 20 per cent of total revenues collected in the NWT in both years, with most of the balance coming from federal government transfers. The largest single source of own revenues is the personal income tax — 37% in 1981 and 44% in 1982, though only 7% and 10%, respectiveiy, of total revenues in those two years.

The range of expenditure responsibilities assumed by the GNWT is, on the whole, significantly less than that in any province. Table 3 provides a breakdown of expenditures by function for the GNWT in 1981 and 1982. The largest operating expenditures in 1982 are for education and public works, followed by health and local government. Expenditures in the NWT are high in per capita terms — in 1980-81, for example, they were $7,362 compared to a provincial average of only $2,515[8] — but

these high expenditures clearly reflect not higher service levels but the higher costs of infrastructure in the harsh northern environment as well as generally higher input prices. In fact, as noted later, service levels are often well below those achievable at much lower costs in the south.

As already mentioned, the NWT does not take part in the federal-provincial equalization program. Even if it were eligible to do so, however, the NWT would ***not,*** under the present rules, receive any transfer under this program because it would not be considered to be a "have-not" unit. This apparent anomaly results because the regional equalization system in Canada — almost uniquely in the world — is based on revenue-raising capabilities alone rather than taking into account expenditure needs also.[9] In terms of per capita revenue-raising ability, the NWT is above the average for Canada as a whole, but because of its climatic conditions and dispersed population, its per capita expenditure requirements to provide a reasonable average service standard are also much higher than the Canadian average.[10] The present equalization formula takes only the former of these facts into account and would hence be of no benefit to the territory even if it were made eligible to receive such transfers.

B. The December 1982 Proposal

Unlike the equalization formula, however, many northern employers — not least the federal government itself — have long recognized northern realities and have offered special benefits and allowances in order to attract qualified personnel to these isolated regions and to retain them once they are there. To some extent, such benefits are designed to ***compensate*** employees for the higher cost of living in the North. In other instances, they may go further and serve as a positive ***incentive*** to entice people to these areas. Although in principle all such benefits have arguably been taxable under the Income Tax Act for many years, in reality, prior to 1979 Revenue Canada had not really insisted that they be reported as income for tax purposes.[11]

In 1979, however, Revenue Canada finally began to assess the value of the benefits provided by some of the mining companies. Strong protests from both employers and employees, however, resulted in the institution of a moratorium on taxing all such benefits until a review of the particular problems of the North could be undertaken. In June 1980 the federal government therefore approved a Remission order which exempted from tax the value of the following specific housing and travel benefits: (1) low-cost housing allowances, or the benefit to employees of receiving employer-provided accommodation at less cost than an employee would have to pay on his own; (2) cash housing allowance, or amounts paid to employees to compensate for the high cost of housing in isolated areas; and (3) travel assistance, or transportation cost for trips that employees and their families take for vacation or medical reasons. These exemptions applied to employees in the North, Labrador and at isolated posts as defined by the Treasury Board.[12]

This Remission Order was reissued for 1981, and in the November federal budget of that year it was further extended to December 31, 1982, for employee benefit plans in place prior to the time of the budget. In December 1982 the exemptions were again extended for one more year, but it was announced that after 1983 these benefits will be included in income. Their inclusion is to be phased in over a four-year period, as follows: 25 per cent of benefits would be taxable in 1984, 50 per cent in 1985, 75 per cent in 1986, and 100 per cent after that.

In considering the December 1982 changes, it must first be emphasized that the non-taxation of housing and travel benefits under the Remission Order (and, less formally, for many years before) had resulted in serious inequities in the tax treatment of different residents ***within*** the North. Since not all employees — let alone all taxpayers — receive similar or, indeed, necessarily any benefits, the advantages of the exemptions were obviously not enjoyed equally by everyone. The resulting ***horizontal*** inequity constituted a serious flaw in the fairness of the tax system and clearly required some redress: people with the same real income and in otherwise similar circumstances were being taxed differently depending upon the form in which they received that income. In addition, some might no doubt object to the apparent ***vertical*** inequity of the exemption since the tax advantage of excluding the benefits from income is obviously relatively greater for high-income than for low-income individuals: to the extent that such "benefits" in effect represent a ***cost*** of earning income, of course, this objection loses weight. The current situation is also open to abuse in that employees, in collusion with their employers, could potentially claim that a substantial portion of what would otherwise be income is "really" non-taxable benefits. All these problems made the need for change pressing.

The scheduled scheme, for taxing travel and housing benefits, to take initial effect in 1984, may be described briefly as follows:

(i) Travel Assistance: the taxable benefit from subsidized vacation travel for employees and their families is to be limited to $250 per trip for two trips a year to the closest metropolitan centre regardless of the actual dollar value of the benefits. The benefit from any additional trips, however, will be fully taxable.[13] The dollar limit on the valuation of travel benefits will be indexed annually to the transportation component of the consumer price index (CPI), commencing in 1984.

(ii) Cash Allowances for Housing: the full value of cash allowances for housing will be included as a taxable benefit.

(iii) Low-Cost Housing Benefits: The value of taxable benefits from low-cost housing will be calculated as the ***lesser*** of a maximum dollar value or 20 per cent of income from employment less the rent actually paid. Table 4 shows that the maximum (or "cap") established for the purpose of this provision varies according to whether employees live in Yellowknife or elsewhere in the NWT. The caps also vary according to type of accommodation (common shelter, apartment/duplex, and house) and according to whether the value of subsidized utilities is included. These dollar limits will be indexed in each year subsequent to 1984 to the housing component of the CPI.

The next section considers the probable effects of the introduction of this system.

III Analysis of the Proposed New Tax Regime

A. Eliminating and Creating Differentials

As noted above, one reason urging a new policy in this area was the unfair differentials among northern residents created by the remission order as well as the perceived differential between northerners and other Canadian taxpayers. The new federal scheme, however, will itself create at least three major inequities within the NWT: between Yellowknife and other locations; between recipients of cash and non-cash allowances for housing; and among those residing in different types of accommodation (common shelter, apartment/duplex and house).[14]

The location differential established between Yellowknife and the rest of the territory (see Table 4) is perhaps in part intended to provide some offset for the generally higher cost of providing equivalent housing in places with lower road accessibility. In addition, since there is considered to be an established housing market in Yellowknife but not elsewhere in the NWT, the proposed limits are apparently intended to reflect the level of market rents in the capital.[15] Since a larger amount will generally be subject to tax in Yellowknife, the value of the implicit subsidy (the amount still exempted) will thus presumably be relatively greater in the more isolated parts of the NWT.

In fact, however, as the partial and (for this purpose) imperfect data in Table 5 suggest, almost all of the limits established appear to be below the actual level of rent presently charged by the GNWT to its employees, with no very clear pattern in the differences, either by type of unit or by region, in contrast to the sharp distinctions set out in Table 4.[16] For example, a duplex without basement rents for approximately the same amount in Fort Smith and Yellowknife, but quite different amounts would be taxed if these units were provided free to employees. More broadly, the variations between communities other than Yellowknife are as great as those between Yellowknife and the rest but these variations are not recognized at all in the formula. Similarly, the variations between types of housing units subject to the same tax limits can, it appears, be at least as great as those between different categories established in Table 4. Since there appears to be little or no greater homogeneity within these categories than between them, it thus seems unlikely that the stated objective of this categorization will be achieved.

If the market rent of a unit is exactly the same in two locations, for example, the differential limits established provide a significantly greater incentive to a person living outside Yellowknife relative to a Yellowknife resident than does the present system of complete exemption. Table 6 illustrates this point for one arbitrary example: in this particular case, the net effect of the cap on two taxpayers in identical circumstances in all respects except their place of residence is to make the person living outside of Yellowknife — for example, in Fort Smith — 7% better off than a resident of Yellowknife. (Both, of course, are worse off than under the remission order.) In short, instead of recognizing the possibly differentially higher costs of living of employees in more remote areas, the new system creates a differential benefit for them even if the costs are the same, a result which seems hard to justify in terms of improved equity.

In addition, under the proposed system, while cash allowances for housing are fully taxable, non-cash allowances (i.e., provision of subsidized rental accommodation) are taxable only up to certain limits, presumably for administrative reasons. As Table 5 suggests, these limits appear to be on the low side, so that the maximum imputed value will in almost all cases be significantly less than market rents. In other words, it seems likely that for almost all subsidized accommodation there will remain an implicit "subsidy" as defined in Table 6 — although

as noted there (and discussed further below) it is arguable whether all of this amount is correctly considered a subsidy from the tax point of view. (Of course, the very existence of the limits or "caps" implies recognition of this argument.)

It is obviously much easier to determine the value of a cash allowance than to estimate the value of a subsidy on rental accommodation. Without knowing what true market rent would be, it is impossible to determine the extent to which the rent actually paid represents a subsidy, but as noted above it seems probable that for most taxpayers receiving in-kind housing benefits there will continue to be at least some "subsidy". One result of fully taxing cash allowances but not subsidized rental housing will thus be that it will become relatively cheaper (other things being equal) to rent accommodation than to purchase it. With a relatively greater benefit from subsidized housing, employees will be discouraged from buying homes, particularly in remote areas, where the benefits are relatively greater. As Table 7 shows, homeownership represents a fairly small share of total dwellings in most parts of the NWT already: even in Yellowknife, less than 30% of dwellings are owned (compared to 55% in Whitehorse and 71% in Labrador City, for example).

This discrimination in favour of employer-provided housing is, on its face, inefficient: transfers are in principle always better than in-kind subsidies (in this case, having the employer provide housing) because they let people choose the package of goods and services which they prefer. A cash transfer allows the employee to take the cash and then choose how much housing services to buy and whether to be an owner or a tenant. The employee is better off when he receives a cash transfer because he has more freedom of choice. The newly-created tax discrimination in favour of in-kind transfers is even harder to understand to the extent that an objective of government policy in the North — as evidenced by the GNWT move to cash allowances — is to encourage a more permanent, home-owning settlement pattern. Since many federal employees in the North may be posted there on a transitory basis, it is perhaps understandable that the federal government itself has continued to provide in-kind transfers for housing: but it is not understandable why the federal tax system should actively discriminate, among those who receive housing benefits, against those who receive cash.[17]

Further inequities will be created by the new system with respect to the three different types of accommodation distinguished in Table 4. In particular, since the limits are lowest for "common shelters", implying a greater subsidy for that type of accommodation, this proposal appears to favour bunkhouses. Such a measure would, other things being equal, encourage employers to convert all accommodation in the NWT to bunkhouses, thus again encouraging a particular form of development which seems hard to reconcile with stated regional development objectives.[18]

A further consideration with respect to the taxation of housing benefits concerns the utilities component. The amount to be charged to taxable income for subsidized utilities that are employer-provided ($100 for a house and $50 for an apartment/duplex) is definitely low. Examples from GNWT subsidized housing, for instance, show utilities charges of $208 for a 3-bedroom house in Rankin Inlet and $118 for a 2-bedroom apartment in Frobisher Bay. In market rate communities such as Yellowknife, utility charges are paid by GNWT tenants where they can be metered.[19]

This new scheme will therefore tend to encourage not only employer provision of utilities whenever possible but also the overuse of electricity and heating fuel by employees. It is hard to believe that this is a rational policy outcome. Moreover, since the amount subject to tax for those benefiting from utility subsidization is constant by housing type across locations, but differs by location, the result is rather two-sided. On the one hand, if utility costs are higher in more remote locations (as seems plausible), residents of these areas receive a higher implicit subsidy, a result which may make sense in terms of the arguments set out later in this paper (and, it appears, accepted at least in part in the federal government's proposed scheme). On the other hand, the fact that the utility component of the addition to the tax base is relatively ***higher*** outside of Yellowknite in the case of apartments and duplexes seems to go the other way. The rationale for charging to tax an additional 14% of "rent" for apartments in Yellowknife for subsidized utilities but 22% in other areas (compared to 30% and 29% respectively for houses) is hard to grasp: these differentials appear to have little connection with market realities, tax equity, or any discernible policy objective.

Finally, the travel provision in the new scheme limits the valuation of taxable benefits from subsidized vacation travel to $250 per trip for two trips per year to the nearest major metropolitan centre in Canada. The $250 amount is apparently intended to reflect an average trip by residents elsewhere in Canada (e.g., Toronto to Montreal) and thus to capture roughly the differential cost of travel in the North relative to the South. Any amount above $250 which is subsidized is thus not taxable on the

grounds that this subsidy merely reflects the higher cost of travel in isolated areas. Moreover, by setting the maximum low, this system takes account of the relatively higher cost of travel to metropolitan centres from more remote areas in the NWT than from Yellowknife. The non-taxable benefit obtained will thus be greater the more expensive the trip.

The travel assistance provision is therefore one part of the new tax regime which explicitly takes into account the differentially higher cost of living in the North, at least for some Northern residents.[20] Unfortunately, the wording of the proposal makes it clear that this benefit accrues only to those who fly to the South, rather than within the North (where there are no "metropolitan" areas by anyone's definition). A resident of Inuvik will thus be able to go to Edmonton partly at government expense, but not to Yellowknife. Moreover, employers who have not previously done so now have a strong incentive to provide ***two*** trips a year to the South for their employees. Again, the desirability of influencing compensation packages in this way is not clear from either a tax or a regional policy perspective.[21]

The limits established for tax purposes with respect to both travel assistance and housing assistance are to be indexed according to the relevant components of the Consumer Price Index (CPI). To the extent that housing or travel prices in the North do not increase at the same rate as they do nationally, of course, the limits will obviously cease to be appropriate, if they ever were. From June 1980 to June 1982, for example, the housing index in Yellowknife relative to that in Edmonton increased by 9.2% while the transportation index fell by 9.5%.[22]

Finally, as the discussion in this section indicates clearly, the new regime will not only continue the present stimulus to NWT employers to increase benefits rather than to increase salary but will also "steer" these benefit packages much more than before — in the direction of providing employees with better accommodation and two trips per year, for example. The benefits, whether measured in terms of improved taxpayer equity or anything else, to be obtained by thus biasing compensation packages are far fom obvious, while some of the costs have been mentioned above.

B. Some Possible Impacts of the New Tax Regime

All employees who receive non-taxable benefits at present will obviously be affected by the proposed change. One estimate is that at least 15,000 employees in the NWT — virtually the entire employed labour force — will be affected.[23] However, not all employees will be affected in the same way.

Federal government employees in the North, for instance, now receive substantial benefits in the form of subsidized housing and utilities. Table 8 provides some detail on 1,261 housing units occupied — and mostly owned — by the federal government in the larger communities of the NWT. The proposed taxation of these benefits up to certain maximum levels, will thus clearly make federal employees worse off unless, as is perhaps not unlikely, they are compensated in whole or in part in other ways by the federal government.

Even if uncompensated, however, federal employees will not be as much worse off as employees of the GNWT, who, as part of the territorial government's policy to encourage home-ownership (and to get out of the housing business), receive cash allowances from their employer.[24] Since such cash allowances are fully taxable under the proposal, while the taxable benefit from subsidized rents is subject to maximum limits, many GNWT employees will obviously be made relatively worse off than before compared to federal government employees.

Table 9 illustrates this effect, which obviously occurs only when the federal employee receives a housing benefit greater than the taxable cash allowance received by the GNWT employee. Two persons, one employed by the federal government and one by the GNWT are assumed to live side by side and to "pay" the same market rent of $1,000 per month (although only the GNWT employee actually has to pay it). Under the Remission Order the tax system already favoured the federal employee in this case since his real income — accepting for the moment that the entire "subsidy" is a gain in real income — was 19% higher than that of the GNWT employee (although the two had the same income if benefits are not taken into account). As a result of the "reform" announced in December 1982, the federal employee will now be 28% better off than his neighbor (although both will of course be worse off with respect to those not in receipt of any taxed benefits)! Again, results such as this are hard to defend in a proposal that has been justified mainly by reference to "fairness"

In the case of GNWT employees, any compensating increases required to maintain service levels will have to be passed on to Northern residents in the form of higher taxes (unless there is a compensating adjustment in federal transfer payments). To some extent, the short-run effect of the change may perhaps be to reduce the "economic rents" that may be received by certain GNWT employees but in

the long run the outcome is likely to be higher taxes or lower levels of service.

Employees of mining companies also generally receive travel and housing benefits. The extent of such benefits often varies both with the operation concerned and with such characteristics of the employee as years of service.[25] Based on a survey of seven mining operations in the Yukon and the NWT for 1981, for example, it was estimated in a recent report that taxation of currently non-taxable benefits would decrease their employees' after-tax annual income (including benefits) by between $2,895 and $4,407 per employee. If employers were to provide increased wages to allow employees to maintain their after-tax income at current levels, the cost was estimated in this study to be, on average, between $3,814 and $15,136 per employee.[26] Finally, this study estimated that the cost of compensating for full taxability would reduce the profitability of the mining companies by between 10 per cent and 100 per cent.

Finally, insofar as the labour costs of producers for ***local*** markets are increased by the proposed change, these firms would find it increasingly difficult to compete with goods and services produced outside the NWT. The more labour-intensive the business, the less competitive it will become. In effect, the present subsidization of employment in at least some such businesses in the NWT may act as a kind of "tariff" barrier protecting local producers from outside competition. If this protective margin is reduced, as will happen to some extent as a result of the proposed tax changes, goods purchased from external suppliers wil become relatively cheaper, thus tending to produce some decline in employment opportunities in the North.

Estimated average losses per employee such as those mentioned above do not take into account important differences ***between*** employees. Any policy for taxing benefits which is based on an "average" approach obviously discriminates between employees at the same location as well as between employees at different locations. Some employees in a given community, for instance, may receive no benefits at all at present: they will not be affected by the change in taxation of benefits. The existing discrimination against such employees (and perhaps the self-employed[27]) owing to the non-taxation of benefits will be removed somewhat by the new tax regime, but there will obviously continue to be inequities between those who receive no benefits and those receiving benefits in various forms, as well as within the latter group. It is far from clear how the cause of greater tax equity in Canada is served by decreasing some inequities while increasing others, especially when, as argued below, there is actually a strong equity case for maintaining and extending some of the "inequities" that are removed.

Implementation of the new tax system would, as noted earlier, seriously discourage homeownership in the NWT since it would induce employees to seek, and employers to provide, subsidized rental accommodation rather than cash housing allowances. This result goes directly against current GNWT housing policy, which is to raise rents to market value and to provide cash allowances for their employees to purchase homes. One rationale behind this policy is the belief that people who buy their own homes will have more of a "stake" in their community and that homeownership will encourage employees to reside permanently in the NWT, thus strengthening Canada's presence in this politically and perhaps economically significant area. A potentially beneficial economic result of a more permanent population might be, for example, a more stable work force.

Another possibility that deserves serious consideration is that some persons now living and working in the NWT may leave as a result of the taxation of benefits. Although Canadian evidence on tax-induced migration — that is, the movement of labour in response to differential effective tax rates when service levels are comparable — is sparse, some estimates are available. Using data on gross migration by families receiving family allowance benefits from 1972 to 1979, for example, one recent study found that tax variables were indeed important explanatory variables affecting migration: the lower the tax rate and the tax burden in the province of destination, for example, the greater was the migration to that province.[28] If this result were assumed to apply to the NWT, there might obviously be some net migration outflow as a result of taxing benefits, perhaps particularly in the most mobile groups of the labour force (those in highest demand elsewhere). Whether out-migration in response to such fiscal changes is "efficient" or not depends in part upon whether the previous situation was efficient and in part on a complex, and inconclusive, set of arguments that have long been discussed in Canada.[29]

Whatever its long-term effects on migration, however, it seems clear that one result of taxing housing and travel benefits will be to encourage the further development of a "bunkhouse economy" in the NWT with "fly-in, fly-out" relations to some southern centre (e.g. Edmonton). The overall effect of the implicit incentive structure created in the income tax will be to encourage temporary residents to fly into the more remote areas to work, while

maintaining their principal residence outside of the NWT. This result seems hardly in accordance with the stated federal aim of promoting a stable work force and population in the North.

The impact on government tax revenues of letting the Remission Order expire completely, it has been estimated, would be to increase GNWT income tax revenues by perhaps $6 million and federal income taxes by perhaps $15 million.[30] The revenue impacts of the proposed changes will of course be smaller, particularly during the transition years, since it is not proposed to tax all benefits. The GNWT revenue gain, for example, may clearly be used, if desired, to offset some of the adverse effects mentioned above. Should some or all of the much larger federal revenue gain also be made available for this purpose, even more may of course be done along these lines: indeed, it may even be possible not just to redress the wrongs which the new system is intended to correct but also those which it will create! Some possibilities along these lines are discussed briefly in the concluding section.

Finally, as has already been mentioned several times, the taxation of benefits must really be considered in the broader context of northern development policy. If the higher cost of living in the North, coupled with higher effective tax rates, discourages permanent settlement in this region of Canada, the potential development of the area will obviously be adversely affected. Very few individuals from the South would probably choose to live in the North, partly because of the significantly highe. cost of living there. Thus, if it is believed that the potential of the North is significant and worth developing, then some form of incentive to attract people there may weil be required.[31] The use of the tax system to create such resource-directing incentives has a long history in Canada and may sometimes be an efficient or at least feasible way to achieve the desired goal. At the very least, tax changes that work in the wrong direction would clearly seem to require explicitly offsetting policies elsewhere in the system.

One difficulty in assessing the impact of the proposed tax regime is obviously that federal policy aims in the North are not particularly clear. The result is that even if the direction of the impact can be discerned, it is sometimes hard to tell if the result is "good" or "bad". With varying degrees of certainty, however, at least three possible policy objectives have been identified in the scanty literature and discussed briefly in this study. They are, in no particular order: (1) reduced GNWT dependence on the federal government, (2) development of the north, and (3) increased homeownership in the north. In all cases, it seems unlikely that the effects of taxing northern benefits under the proposed regime will be particularly helpful in attaining these objectives.

In addition, two more narrowly "tax policy" objectives have been identified and discussed: (1) equity and (2) efficiency (in the sense of not distorting private decision-making). Again, while the proposed new regime clearly is in some respects better than the Remission Order with respect to these objectives, its superiority is by no means overwhelming since it creates almost as many differentials as it eliminates. Moreover, and most importantly, the new system neglects completely the most significant tax policy issue of them all — the case for regional tax differentials in Canada. The next section of this study therefore develops this case in some detail as a necessary preliminary to the discussion of possible alternative policies in Section V.

IV. Analysis Of The Issues

Although the basic tax policy issues involved in determining the appropriate tax treatment of northern benefits are far from simple to resolve, the December 1982 proposals seem unlikely to represent the best of all feasible solutions. Before discussing some alternative solutions, however, it is essential to set out what appear to be the basic issues more clearly than has been done in most of the discussion of taxing northern benefits in Canada. The present section therefore first raises a few pertinent general considerations on the taxation of fringe benefits and then considers more explicitly the strong equity and efficiency arguments for more explicit regional tax differentials in Canada with, of course, particular attention to the special (and extreme) case of the North.

A. The Taxation of Fringe Benefits

The taxation of fringe benefits is an exceedingly complex question, and it is neither possible nor necessary to attempt to unravel all its complexities here. It is, however, both useful and relatively simple to set out briefly some major propositions that cast a rather different light on the taxation of many northern benefits.

In the first place, there is fairly general agreement among tax experts that ideally all forms of compensation, whether received in kind or in costs, should be included in the tax base in order to ensure fairness and equity among taxpayers.[32] The Royal Commission on Taxation, for example, called for full inclusion in the tax base of all net gains in cash or kind derived from the performance of personal services.[33] In addition, unless income in kind is included in gross income for tax purposes, compensation and employment decisions will tend to be distorted in favour of in-kind compensation and in favour of those activities in which such compensation is more readily provided: economic efficiency therefore also appears to require, in principle, that all fringe benefits be included in the tax base.[34]

As is so often the case, however, while there may be general agreement in principle, there is much less agreement in practice among the experts on what to do. The disagreements center on two — to some extent related — issues: first, how should fringe benefits be valued for tax purposes, and, second, when is a "fringe benefit" not a benefit at all. As for the first of these questions, there are at least three possible valuations of any given benefit: fair market value, employer's cost, and the value to the employee. The last of these three possibilities may have some justification in equity,[35] but it seems so obviously unworkable in practice that it has not generally received much credence from either economists — who generally prefer market value[36] — or administrators — who have often opted for employer's cost (a base for which the equity argument seems non-existent, but which is easy to determine) or market value.[37] In fact, however, as shown below, there is surprisingly widespread agreement that certain "benefits" which do not add to a taxpayer's well-being in any real sense are not, so to speak, really benefits at all: in this sense, the "value to the employee" concept may also be said to be used even in the Canadian tax system, though less so than in many other countries.

In the United States, for example, benefits provided primarily for the convenience of employers — for example, lodging which employees must utilize in order to perform their duties properly — are excluded from gross income.[38] A 1975 Treasury document similarly proposed excluding from income, for example, benefits from facilities controlled by the employer for business purposes which were made available to all employees at no substantial additional costs.[39] In both cases, the essential argument is that the "benefits" in question are not primarily intended to compensate employees but rather to

further the business activities of the employer. The "special work site" rule in Canada (Section 6(6)), which excludes from income certain benefits received when temporarily employed at a special work site or remote location, may perhaps be rationalized in part on the same grounds.[40]

The United Kingdom provides a much broader exclusion of accommodation benefits from taxable income where it is "customary" for employees to be provided with accommodation and where the accommodation is provided for the better performance of the duties of the employee.[41] The possible analogy to conditions in most of northern Canada is obvious.

Similarly, in Australia the value of any taxable benefit from employer-provided accommodation may be discretionarily reduced for people living in remote sites, where it is customary to provide such accommodation, or where the taxpayer has no reasonable alternative accommodation.[42] The maximum amount that can be assessed in such cases is in any case 10% of the market rental value less any rent paid by the employee. Australia is even more interesting in connection with the present subject because it also grants special tax deductions ("zone allowances") to persons living in remote areas: the Australian system is for that reason described briefly in Appendix B and is referred to again later in the present study.[43]

Canada thus stands in some contrast to the United States, the United Kingdom, and Australia, in its lack of an explicit statutory exemption of benefits from taxation when accommodation is provided to an employee by reason of his employment so that he may properly carry out his functions. In the other three countries, it appears the value to the employee of such in-kind benefits is assumed in effect to be negligible for tax purposes: in short, a measurable fringe benefit is quite consciously not included in income because it is assumed that it is not "enjoyed" by the employee in any meaningful sense.[44] A "fringe benefit" that simply compensates an employee for additional costs and inconveniences imposed on him by the conditions of his employment — thus placing him in more or less the same position as an identical individual without either the costs or the benefits — is not, so to speak, a fringe benefit at all so far as the tax systems of the U.S., the U.K., and Australia are concerned (at least in some instances).

While it is far from clear why Canada has, on the whole, taken so different a stand in recent years on this matter with respect to the principles involved in taxing northern residents, the aim in this section is not to argue for any particular tax treatment of those living in the north, but rather simply to demonstrate that there is in fact no very solid argument from tax theory for the uniform inclusion of all so-called "fringe benefits" in the tax base. Contrary to what was asserted in the November 1981 Budget, therefore, it is by no means self-evident that "the tax-free status of such benefits is inequitable for employees who cannot receive them."[45] Indeed, from the point of view of horizontal equity, presumably a concept that lies at the core of Canadian tax policy, a quite different conclusion may in fact be drawn than the simplistic "tax everything" set out at the beginning of this section. This point is developed further in the next section with respect to the proper taxation of northern residents.

B. The Case for Regional Tax Differentials

As noted earlier, a progressive income tax rate structure, when combined with the higher cost of living in the North, results in generally higher ***effective*** rates of tax being applied to a given real income in the North than elsewhere in Canada. This result comes about as follows: the higher regional cost of living results, broadly, in otherwise comparable employees receiving higher before-tax incomes in the North in order to put them in roughly the same position as their Southern counterparts. Higher incomes, however, under a progressive rate structure move individuals into higher marginal tax brackets, with the result that, on average, the effective rates (taxes paid relative to income) are higher in the North at all levels of "real" income.[46] As a result of the higher average tax rate in the North, however, the disposable (after-tax) income left to a Northern resident, even one whose gross pretax income was adjusted for the cost-of-living differential, will be insufficient to provide a comparable standard of living to that which would be provided by the same gross income in the South.[47]

The problems arising from ***spatial*** differentiation in costs are thus obviously strictly analogous to those arising from ***temporal*** differentiation. It is now widely accepted, not least by the federal authorities, that inflation over time combined with a progressive rate structure distorts the real structure of the income tax.[48] Prior to the introduction of partial indexing of the personal income tax in Canada in 1974, inflation resulted in more income being shifted into higher marginal tax brackets even though taxpayers experienced no increase in their ***real*** (before tax) incomes. Moreover, since exemptions, deductions and rates in an unindexed system do not increase at the same rate as inflation, taxable income rose

even more quickly than total income. Individuals' tax liabilities thus increased when real incomes were constant — or even if they were falling — and the effective rate of tax tended to increase over time. To get around some of the inequities created by inflation, the indexing of personal exemptions and tax brackets was introduced to guarantee that ***real*** tax burdens would not increase unless real income increased: the equity achieved by the form and scope of indexing that was implemented may have been only rough, but it was clearly better than that attained in the absence of indexing.

Tax burdens should in principle not only be compared in ***real*** terms over time, however, but also across space, and for exactly the same reason: all possible rationales for applying progressive tax rates turn on the assumption that the progressivity applies to differentials in ***real*** income. Since the cost of living varies geographically in Canada, and the marginal tax rate schedule is progressive, the inevitable result is that real tax burdens are ***not*** comparable across space under the current tax system. Canadians therefore face different effective federal tax rates depending upon where they live in the country. The effects of applying a nominally uniform federal tax rate structure to taxable incomes which in fact represent widely differing amounts of real income are thus, it may be argued, inherently inequitable in principle.

Within Canada as a whole, nevertheless, it may be acceptable, or at least expedient, to ignore this problem.[49] This conclusion can not be reached so quickly with respect to the North, however, because the inequities created by ignoring regional cost differentials are so large. A recent price survey comparing Yellowknife to Edmonton in June 1982, for example, found that the cost of living was more than ***28 per cent higher*** in Yellowknife than in Edmonton.[50] (See Table 10) By way of comparison, the largest inter-city differential found between southern cities in 1979 in a recent study was less than 7% — and if St. John's was left out of the sample, the largest inter-city differential was less than 1%![51] It is thus nonsense to talk about high housing costs in Toronto or Edmonton as if they are comparable to high housing costs in Yellowknife — where in any case housing is more than 50 per cent more expensive than in Edmonton. The real point is that in these southern cities higher costs in one area tend, as a rule, to be offset by lower costs in others, while in the North ***everything*** is high cost. Earlier official estimates, for example, suggested that the cost of living was anywhere from 25 per cent to 90 per cent higher in the various regions of NWT than in Canada as a whole, with the difference on average being around 50 per cent.[52] More recent data based on Statistics Canada's Living Cost Differentials for Isolated Posts similarly show that the living cost differential for the NWT was 145 compared to the Southern city average of 100, with the range being from 127 in the region of Fort Smith to 179 for the Baffin region. Since Yellowknife is probably one of the cheapest places to live in the NWT, these various estimates are generally quite consistant with the figures quoted above. The cost-of-living differentials between north and south are, it appears, at least as great in magnitude as the temporal differentials the perceived inequity of which led to the adoption of indexing in 1974. In these circumstances, it is extremely hard to understand how a move in the other direction can be justified in terms of improving the "fairness" of the tax system.

In a recent interesting study, James Dean has used data from the 1978 income tax structure to estimate the impact of indexing northern personal exemptions and tax brackets by a cost-of-living differential index. Assuming — not unreasonably on the basis of the scanty evidence available — that the cost of living in the NWT is 150 per cent of that in the rest of Canada, the results of this study, presented in Table 11, show that, in the absence of adjustment for the cost of living, ***effective*** federal tax rates on the ***same*** real income are from 31 to 67 per cent higher in the NWT than they would be under an indexed structure intended to produce comparable results to the tax structure faced by comparable Southern taxpayers.

Another implication of this discussion is that the assertions often heard about the relatively low territorial income tax rate and the relatively high fiscal capacity of the NWT are also misleading. In fact, contrary to the superficial comparisons of nominal tax rates that underlie such statements, the effective territorial tax rate is probably higher in the NWT than anywhere in Canada. Table 12 illustrates how this comes about by comparing a hypothetical taxpayer in Manitoba, where the provincial rate in 1981 was 54% of the federal tax, with the NWT, where the territorial rate was only 43% of federal tax.[53] As can be seen, because of the cost-of-living adjustment, in fact both the federal ***and*** the territorial taxes impinge much more heavily on the NWT resident.

The appropriate taxation of northern allowances must therefore be considered in the context of this discussion of spatial indexing. To the extent that such benefits are not taxable, the effective tax rates on those receiving them are, of course, lower than they would otherwise be. In effect, the higher effective tax rates that result from the impact of the dif-

ferential cost of living under a progressive rate structure are to some extent offset. On the other hand, tax-free benefits — whether under the Remission Order or the proposed new scheme — are not available to everyone living in the North, while the impact of the higher cost of living on the effective rate of tax does affect everyone. A more direct attack on the spatial indexing problem would thus be more equitable and hence preferable in principle as discussed in the next section. In any event, the conclusion that there is a strong case in equity for favorable treatment under the federal income tax of income earned in the NWT seems difficult to refute.

Tax differentials across jurisdictions may also be justified on ***efficiency*** grounds, although this argument is not developed at length here.[54] Even in the perfect "federation" of conventional economic theory, for example, geographically differentiated national taxes, like differential local taxes, are justified where differential levels of service are provided. What is required for efficiency in these circumstances is a uniform "fiscal residual" (or differential between taxes paid and benefits received (at the margin) by taxpayers at each income level), not uniform tax rates.

Parts of this argument may obviously be applied to the cirumstances of the NWT. Expenditures per capita are much higher than elsewhere, for example, but to a large extent this differential clearly reflects higher ***costs*** in the North, not higher levels of service. In fact, people in the North may well receive less service for their real tax dollars than elsewhere in the country. If so, the effective taxes to which Northerners are subjected ought to be ***lower*** than elsewhere on efficiency grounds, not higher as is in fact the case (at least if all "income" is subject to tax.) If the resources to finance the desired level of services are scarcer in the NWT than elsewhere, there is again a strong case, as was demonstrated decades ago, for a geographically differentiated ***federal*** income tax as a substitute for, or complement to, regionally differentiated transfers.[55] Finally, if it is assumed that one objective of federal policy is to develop more fiscal responsibility and local autonomy in the North, there are a surprising wide range of other arguments that similarly point in the direction of more explicit recognition that the north is not a region like the others.[56]

Although the "efficiency" arguments for northern differentials have been more hinted at than elaborated here, it should nevertheless be clear both that such arguments exist and that in general they reinforce the strong equity case developed above. There are also cogent administrative and political reasons arguing against a special tax regime for the NWT: it might, for example, be difficult to draw the line between the NWT (and Yukon?) and other remote northern areas, and, like all tax differentials, some abuses, hardships and, at best, "rough justice" could be expected. On balance, however, the conclusion is inescapable that the case for a northern tax differential is much stronger than usually recognized, especially in terms of improving the equity of Canada's federal personal income tax system.

V. Alternative Approaches

A. A Revised Proposal

If the December 1982 scheme announced by the federal government is to be implemented, at the very least certain revisions seem needed to reduce the new inequities that would be created by the various differentials established in this scheme. Ideally, however, as argued in Section IV, the correct equity objective would be to go further and to attempt to make the ***real*** tax burden the same for individual taxpayers in equal situations in the North and in the South, by altering the system to reflect more accurately the higher cost of living in the North.

This first subsection suggests some revisions within the general framework of the December scheme, while the next subsection proposes some more adequate solutions to the basic problem at issue here — the fact that the net discretionary income per dollar of gross income in the North is significantly less than in the south. The final subsection then considers briefly whether fiscal equity can be restored by altering expenditure rather than tax patterns.

As noted earlier, the higher cost of housing is one of the most notable components of the northern cost differential — a fact recognized both by the provision of housing or housing allowances to many northern employees and by the special tax treatment proposed for northern housing benefits. Some of the problems with the proposed scheme were set out in Section III above. To avoid many of these problems, while at the same time recognizing the higher cost of housing in the NWT, one attractive solution might be to value the taxable benefits from subsidized housing ***at comparable prices for accommodation elsewhere in Canada.*** For example, if an average house rents for $500 per month in Edmonton (or some composite Southern city), then $500 per month would be set as the taxable benefit for a house in the NWT. Any implicit subsidy over this amount (i.e., where the market rent is greater than $500) would be taken to reflect purely the high cost of living in the NWT and would thus not be taxable. That is, if a house has a "market" rent of $1,000, but a comparable house in (say) Edmonton has a market rent of only $500, the taxable benefit would be limited to $500 less any rent paid by the individual. The same rule would apply if the market rent were $1,500 or $750, or $500.[57] (A somewhat similar scheme might in principle be applied to the higher cost of living in the north in general — but this would be close to the increased exemption discussed in the next section.)

The problem of unintended differentials between Yellowknife and more remote areas in the NWT would be alleviated by this proposal since higher prices for accommodation in isolated areas would simply result in a higher (non-taxable) subsidy. Each post would, in effect, be compared to (e.g.) Edmonton, thus removing the inequities created by specifying differentials for Yellowknife and other posts (see Section III). Each type of accommodation (house, apartment/duplex and common shelter — perhaps even with some finer gradation, as in the GNWT housing data) would similarly be compared to comparable accommodation in Edmonton (or the base city or cities).

This revised proposal is obviously very much along the lines already accepted by the federal government for the taxation of travel benefits and would, like that system, treat individuals in the North and in the South in a roughly comparable manner. The benefit an individual received would not be taxed to the extent that it reflected the relatively higher cost of living in isolated areas. If, for example, an employee was charged a rent that was ***less*** than the market rates for Edmonton, in effect he would be receiving not simply ***compensation*** for higher living costs but also an additional ***incentive*** to locate in the NWT. Any such noncompensating in-

centive would be subject to tax[58] — unless, of course it was desired positively to encourage people to live in the north rather than simply to treat fairly those who chose to do so.

In terms of valuing these taxable benefits, it would only be necessary to compare the rents actually paid in the NWT to the standards set for Edmonton (or wherever). It would never be necessary under this scheme to know the actual market rent because the real subsidy (the difference between the market rent and the actual rent paid) is not taxable anyway. What ***is*** taxed is simply the value of comparable rents in Edmonton.

Along similar lines, the differential between cash and non-cash allowances would be reduced if only that portion of the cash allowance which represents an incentive as defined above, as opposed to that portion which reflects the higher cost of living, were to be taxed. In this case, however, an explicit comparison would be needed between the market value of housing in Edmonton and the value of similar housing in the NWT in order to establish what part of a cash allowance is compensation and what part is a subsidy. The procedure envisaged can be illustrated by assuming in the preceding example, first, that the allowance is $400 — then no tax would be levied because the allowance is less than the market value ($1,000) ***less*** Edmonton rent ($500) — and, second, that it is $600, in which case $100 would be subject to tax. If the market value in the NWT were $1,200 however, the $600 allowance would not be taxed, while if the value were $800, $100 or even the $400 would be taxed.

This procedure is obviously administratively much more demanding, so possibly an acceptable and more feasible solution might be to use the housing component of the CPI to adjust the "taxable base" For example, if on average housing in the NWT is twice as expensive as roughly comparable housing in the South, the presumed value of housing for purposes of calculating the taxable component of cash allowances would be taken as ***twice*** Edmonton (southern) levels. The procedure would be as above with the exception that the (presumably) known market rent of $1,000 is replaced by a presumed market rent of 2 × $500 = $1,000. This procedure would obviously result in underassessing benefits to those taxpayers receiving cash allowances in more expensive areas and — more dangerous perhaps — in overassessing others. Even in the latter case, however, the degree of overassessment relevant to those receiving in-kind subsidies would probably be less than under the December 1982 proposal.

A quite different way that has been suggested to revise the December scheme would be to tax everyone on the basis of the ***full market value of the benefits*** (assuming these can be determined) up to some limit for total benefits, e.g., $5,000. One advantage of this approach is that it would allow employers to choose the benefits they will provide rather than being (in effect) forced to provide subsidized housing and utilities and two trips per year, as under the current system. On the other hand, in addition to the obvious serious problems of valuing the benefits, imposing a fixed limit will create inequities between those who receive benefits of greater value and those who receive benefits less than (or equal to) $5,000. More importantly, unless this approach is combined with (e.g.) a special northern deduction, it would accentuate rather than alleviate the basic inequity in the present federal taxation of northern residents.

Indeed, all possible revisions within the framework of the current scheme inevitably suffer from their failure to deal with the two basic inequities in both the pre- and the post-December 1982 systems — the inequity between the tax treatment of benefit recipients and other Northern residents and the inequity between Northern residents and other Canadians. The next section therefore turns to approaches which might potentially resolve both of these problems at once by treating Northern residents as a group separately from other Canadians rather than focussing on only those Northerners who receive benefits in particular forms.

B. Other Tax Approaches

As argued in Section IV, regional cost-of-living differentials are similar to differentials over time: in both cases, when the differentials are marked enough the solution of indexing commends itself. Indexing the personal income tax for inflation involves indexation of personal exemptions and the rate structure by the consumer price index.[59] ***Spatial indexing*** could similarly index personal exemptions and rates by a cost-of-living index that varied geographically.

Spatial indexing might in principle be somewhat more complicated than temporal indexing because the appropriate index would, in principle, be different for each location. For simplicity, however, one index could be used for all of Canada north of the 60° line. The advantage of using one index for north of 60° is obviously simplicity. The major disadvantage is equally obviously that, to the extent that the cost of living is very different than the average for the North in a particular location, discrepancies will arise. A possible compromise

might be — as in the current Australian scheme described in Appendix B — to provide two indexes, one for larger centers and one for more remote locations. Whatever the precise technique of spatial indexing adopted, the resulting "justice" would undoubtedly only be rough — but it would also be preferable in equity terms to that produced by either the old or the new systems of taxing northern benefits.

An alternative approach to the same goal might be to ***reduce federal tax rates*** in isolated areas. One problem with this approach is to determine by how much to reduce tax rates. As with the indexing problem, different rate reductions might in principle perhaps be required for different locations, but this degree of refinement seems undesirable. In addition, since the NWT income tax is piggybacked on the federal personal income tax, the implications for both territorial and federal tax revenues of such rate changes would have to be considered carefully. Under a progressive rate structure, taxpayers in higher tax brackets pay a relatively larger percentage of any taxable benefits in taxes than do low income people: the inevitable result is of course that a general rate reduction would generate relatively larger tax savings for high income individuals. Although, if this outcome is considered unacceptable, any rate reduction might be differentiated according to income class, this reaction would seem unwarranted in view of the fact that what is really being done by the rate reduction is to reduce the taxable base in order to get a fairer increase of the ability to pay of northern residents. Even if tax rates are reduced, many other federal programs, such as the child tax credit and old age supplements, which depend on some measure of net income or taxable income, would still be improperly affected by the higher "incomes" attributable to higher living costs.[60] For all these reasons, in addition to its basic political unpalatability, explicitly lower federal tax rates are perhaps the least desirable approach.

In contrast, a ***deduction from income*** for residents in the North is a relatively attractive approach. One problem with this approach, however, is that in principle ***all*** benefits would have to be included as income for tax purposes before permitting the deduction to account for extraordinary expenses in the North to be subtracted from income to arrive at taxable income — more or less on the grounds that this deduction reflects the exceptionally high cost of earning income in the North. To the extent that benefits go beyond those required to meet the higher cost of living, they would of course be taxable. The benefit valuation problems mentioned earlier would thus have to be faced, and resolved, in some manner in order to adopt this (or, indeed any) approach to taxing all northern residents more equitably.

Ideally, any such deductions should also be variable by location. Since it is more expensive to live at an isolated post than in Yellowknife, for example, the deductions would be higher for the isolated area. The GNWT has estimated the cost-of-living differentials by community and has proposed the applicable differential deductions, as summarized in Table 13. The complexity suggested in this table seems unlikely to be attractive to any tax administrator, but the range shown in the table — from $3000 in Yellowknife to $12,000 in Pelly Bay — suggests strongly the need for at least some differential ***within*** the North in any scheme that might be adopted.

Deductions may also, of course, be criticized as regressive in incidence since all taxpayers (in this case, all taxpayers in a particular region) can deduct the same amount from their income. Given rising marginal tax rates, the tax savings from such a flat deduction will be greater the greater one's income. While the deduction could of course be varied by income class, reducing its value as income increases, the added complexity this would introduce makes the whole idea seem even more unlikely. More importantly, since what is in effect involved here is the appropriate definition of ***net*** income for tax purposes, this objection seems to be fundamentally misconceived. If a dollar of income in the NWT really gives its recipient less in terms of discretionary economic power than does a dollar in the rest of the country, then it does so regardless of how many dollars the recipient has. The basic equity case for a northern differential requires adjusting the tax base to improve ***horizontal*** equity, irrespective of its distributive or vertical equity dimension.

A final approach to a regionally-varying and income-varying deduction might be by means of a ***tax credit,*** in effect a credit against taxes payable that would reflect the differential cost of living in isolated areas. The credit could, again, if desired, be reduced as income increases so that the greatest advantage would go to low-income taxpayers, but this refinement seems unnecessary since the credit mechanism itself insures that the taxpayers at all income levels get the same benefits in dollar terms. Indeed, since the credit could also be made ***refundable,*** even those whose incomes are too low to pay taxes might in principle receive benefits in the form of a transfer payment from the government.

Interestingly, a cost-of-living credit would not be a novelty in Canada. Manitoba already has such a Cost-of-Living Tax Credit, calculated as 3 per cent of personal exemptions minus one per cent of net family income, this credit is refundable. Presumably, it is assumed that personal exemptions, which are indexed for inflation, reflect the increasing cost of living over time. Similarly, in a family with more children, personal exemptions would be higher, so the credit would also be higher. The subtraction of a fraction of net family income ensures that the higher one's income, the lower the credit received. Other provinces have other types of credit — for example, property tax credits, sales tax credits, and home heating credits (with the latter — in Ontario — reflecting the higher cost of fuel), as summarized briefly in Appendix C.

There are thus obviously many precedents under the existing tax collection arrangements for regionally varying tax credits, some of which are not all that different in concept from a possible NWT credit to allow for the differentially higher cost of living in different parts of the North. The cost of implementing any tax credit program would obviously depend on the amount of credit and the portion of income (however measured) subtracted from it. In addition, if — as would probably be necessary — it were to be a territorial credit, then the issue of which level of government will pay for it becomes crucial, as is discussed briefly in the next section. Finally, an important argument ***against*** the credit approach is that it does not adequately recognize the "cost of earning income" argument which lies at the heart of the case for differential taxes in the North. This argument, as already noted, requires an adjustment to tax ***base*** rather than simply to tax, if it is to implement the presumed intentions of those who designed the rate schedule in terms of progressivity.

An NWT tax credit might again vary according to the region of residents (see Table 13 again) and could be based on various aspects of the cost of living — housing costs, food, fuel and taxes — or on a combination of all of them. Such a credit would be available to everyone (whether or not they received benefits): in particular, it would apply both to homeowners and renters, thus reducing the inequities created under the new scheme by the differential treatment of owners and renters and of those receiving or not receiving benefits.

C. Non-Tax Approaches

There are, of course, other ways than through the tax system by which people can be compensated for the higher cost of living in the NWT, as is obviously required on equity grounds. In particular, subsidies could be provided by the federal government directly to individuals resident in the North or indirectly through transfers to the NWT government to be passed on to individuals. Alternatively, subsidies could be given to the NWT government to allow it either to reduce its taxes or to provide more (or better) public services.

Subsidies to individuals might, for example, be made on a per capita basis, with each eligible person receiving an annual subsidy. Such a grant would be relatively simple to administer and would not create distortions (such as that between renters and owners). It could also apply to all individuals, not just taxpayers. A flat per capita grant, however, would obviously not recognize the nigher cost of living in the more remote areas. More generally, such a grant would not recognize individual needs very adequately because it is not related in any clear way to costs incurred.

An obvious alternative to a flat per capita grant would therefore be a grant which varied by region and by costs. For example, the grant could be higher where the cost of living is higher in remote areas (see Table 13 again). Subsidies might be based on the actual cost of housing, and other living costs, for example, with a certain proportion of these costs subsidized up to some limit. Such a limit would have to be specified because a subsidy of this sort seems more likely to stimulate expenditures on the subsidized items than the tax credit it otherwise resembles. Like the credit approach, however, all such subsidy approaches fail to deal directly with the basic cost-of-living differential which presumably motivates them.

Alternatively, the federal government could also provide a ***transfer to the NWT government*** in order to recognize the impact of the higher cost of living on its residents. Indeed, one of the standard economic justifications for unconditional transfers is precisely on the grounds of fiscal equity, in order to allow all jurisdictions to be able to provide some "average" level of public services by exerting an "average" fiscal effect, usually measured by the tax rate. Canada's revenue equalization system is clearly partly motivated by this objective, but it fails to take any account of the regional differences in cost which are the heart of the matter here. In the case of the NWT, a special equalization grant can obviously be justified on the grounds that costs are higher and the needs greater than in either jurisdictions. To apply the present equalization formula would not serve this purpose, however. A proper formula should be based not only on taxable capacity,

as is currently done, but also on the needs of the jurisdiction. At the very least, the "true" taxable capacity of the North would need to be calculated by adjusting for cost differentials on the revenue side (that is, the reduced taxable capacity) even if the federal government were reluctant to enter into the potential morass of "need" calculations.

The impact of any unconditional grant to the GNWT on individuals in the North also must be considered. Evidence on other federal-provincial and provincial-municipal grants suggests that they tend to increase spending by the recipient government to some extent but that more often they reduce the taxes of the recipient government.[81] An expanded federal-territorial unconditional grant might therefore reduce territorial taxes, and in this way, provide a certain degree of relief to NWT residents, with the precise distribution of this relief depending upon the nature of the tax reduction — or, for that matter, expenditure increase — as a result of the grant. A less unstructured result could perhaps be secured by tying the grant explicitly to the amount required to fund, for example, a territorial tax credit of the sort sketched earlier.[82]

Finally, with respect to any new grant or tax incentive program, it would presumably be essential to distinguish the case of the NWT (and probably the Yukon) from more general federal tax policy. Even if the principles used to rationalize differential treatment in the territories may be more broadly applicable, as a practical matter it can be argued that differences in both degree — of the relatively very high costs in the North — and kind — they are not provinces and federal policy objectives are rightly different — may justify corrective measures limited to the North alone.

On the whole, however, desirable as changed federal-territorial transfer programs may be — for example for the reasons sketched in Section II above — it seems most unlikely that the basic case for improving the equity of the federal income tax as it affects Northern residents can be satisfied by fiddling with these programs. The only feasible alternatives then, appear to be on the expenditure side special grants to northern residents and on the tax side special northern credits, deductions, or special indexed exemptions (and rate brackets). Of these, subsidies and credits do not in fact deal with the basic equity problem that a dollar earned in the North is not the same as a dollar earned elsewhere in terms of the discretionary economic power (or taxable capacity) it bestows on its recipient. The choice is therefore reduced to either a special deduction or a special indexing provision, with, however, there being considerable scope for variations within each of these approaches.

VI. Conclusion

All things considered, the best approach in terms of improving tax equity without unduly complicating either federal tax administration or federal tax politics (particularly relations with the provinces) would appear to be by introducing a simple two-zone allowance system, to be indexed from year to year in accordance with the general indexing factor applied to personal exemptions.[63] On the basis of the scanty evidence available, it would appear that an additional factor of 25% applied to personal exemptions ***and*** to the bracket limits for residents of Yellowknife and other larger centers in the NWT and 50% for more remote regions would seem to provide a degree of at least rough justice which is completely lacking in the present system. The precise adjustment factors should be determined by a more careful study and presumably adjusted every five years or so.

This approach to improved tax equity would still leave the difficult, if not impossible, task of assessing fairly the value of the fringe benefits that seem likely always to constitute a significant ingredient of employment relationships in the harsh environment of the North, so the introduction of this limited form of spatial indexing should be accompanied by a change in the valuation rules as proposed in Section V-A above. Even if the strong logical case for limited general tax relief in the North is somehow denied, at the very least the "comparability" approach now used to value travel benefits should be extended to other fringe benefits in order to reduce the inequities created by the proposed new system (and by the existing Remission Order). This approach too has its problems but it seems clearly better in equity terms — the terms by which Canadians have been asked to judge the December 1982 system of taxing northern benefits. More broadly, however, the major equity issues in federal taxation in the North affect all northern residents, not just those in receipt of benefits, and call for broader relief measures of the sort sketched in the preceding paragraph.

Appendix A

Benefits Received by Employees of GNWT, 1982

1. **Accommodation Allowance**

   An annual payment of $5,400 per employee is paid to all GNWT employees not living in subsidized housing. This amount is paid on a per employee basis (rather than per household).

2. **Vacation Travel Assistance**

   Employees are eligible to receive one trip per year per family from their place of employment to their point of departure (or in any other destination, provided that the cost is no greater than travel to the point of departure). Alternatively, they may receive Land Travel Assistance in cash when travel is by means other than scheduled or chartered aircraft. The amounts of this assistance are $200 per employee per trip, $175 per spouse per trip, and $75 per child per trip.

3. **Settlement Allowance**

   An allowance is provided to reflect regional differences in costs as compared to Yellowknife. Communities have been divided into eight categories, each with a different settlement allowance ranging from zero to $5,588 in 1982. These amounts are expected to increase by 6 per cent in 1983 and by 5 per cent in 1984. The assignment of settlements to the various categories closely parallels that used in the federal directive on isolated posts. This allowance is already taxed.

Appendix B

Zone Allowances in Australia

"Zone allowances" in Australia are provided for taxpayers living for more than half of a year in remote areas for a period of time. These allowances take the form of tax rebates, and their size depends on the remoteness of the region. Zone A, the most remote zone, roughly covers the area above the 26th Parallel except for a southeastern slice of Queensland. Zone B covers the rest of Western Australia (except for the southwest corner), the more remote parts of South Australia, New South Wales and Tasmania and the central region of Queensland. In effect, most of the (sparsely inhabited) geographic area of Australia is covered by these allowances.

The tax rebate, or reduction from income taxes payable, for Zone A in 1982 was equal to $216 plus 50 per cent of any entitlement to rebates in respect of dependents. In Zone B, the rebate was $36 plus 20 per cent of the rebates for dependents, sole parents and housekeepers. In the case of residents of Zones A and B who lived more than 250 kilometers from a centre of 2,500 or more people, the basic rebate is $750 instead of $216 or $36, respectively. Both the percentage figures mentioned and the $750 figure represent a significant increase in this allowance from the 1981 system ($216 plus 25% for Zone A, and $36 plus 4% for Zone B, with no special provision for more remote areas within these zones).

The primary rationale usually given for zone allowances in Australia is the need to establish horizontal equity between persons living in remote areas and those living elsewhere: to quote the Taxation Review Committee (p. 175), "horizontal equity, in this respect, could not be achieved by any feasible measures on the expenditure side of public finance". Another obvious motivation for the allowances when they were first introduced in 1945 was to encourage employment in remote districts. The original allowances were thus intended to abate the effect of high taxes on allowances which were given to employees to compensate for "uncongenial climatic conditions, isolation, loss of social amenities and higher cost of living" (Treasury Tax Paper, p.25).

The zone allowances originally took the form of a tax deduction rather than a tax rebate. It was felt by the Taxation Review Committee, however, that, since deductions are more valuable to high income taxpayers and there was no reason to believe that higher income residents suffer greater hardship in remote regions, a tax rebate would be more appropriate. Although, as shown in the present study, this argument is not very persuasive, the allowances were changed to rebates in 1975. At the same time, the qualifying period of residence was changed to include people who spent more than half of a year in remote regions even if this period did not constitute half of a taxation year (which is different from the calendar year in Australia).

With respect to the magnitude of the basic concession (now $216 and $36, respectively, for Zones A and B), these amounts have not changed for several years. However, since the rebates for dependents usually change annually in the Australian tax system, the formula for the zone allowances leads to an automatic increase each year for families. The estimated revenue cost of zone allowances was $42 million for 1980-81.

A tax credit of the type used in Australia could obviously be used in Canada to get around the problem of over-taxation of residents in the north (see the discussion of tax credits in Section 5). A particularly interesting feature of the Australian allowance is the differentiation by degree of remoteness. Not only are the remote areas divided into two categories — Zones A and B — but even within these categories, a higher rebate is given to residents of particularly isolated areas (more than

250 kilometres from a centre of 2,500 or more). This recent liberalization resulted from the report of a 1981 Committee and is intended to reflect the differentially higher cost of living in the most isolated posts. (Incidentally, at least with respect to this area of taxation, Australian governments seem to implement committee reports almost instantaneously!)

The report of the 1981 inquiry committee (especially the lengthy dissents from two of its four members) suggest strongly that there were few significant arguments made against the zone allowances and very strong support for them, particularly on grounds of differential costs and horizontal equity (***Report,*** pp. 14, 20). The only significant voice to the contrary come — to no one's surprise, perhaps — from the Commonwealth (federal) Treasury on the grounds that regionally-differentiated tax concessions fostered resource misallocation (pp. 15-16): although the committee accepted the argument, perhaps too quickly, it nevertheless concluded that the allowance system dispensed, at least, very rough justice to residents in the affected zones since the benefits received varied so much from person to person (p.30). Nevertheless, while it found the zone allowances to be far from perrfect in many respects, the committee concluded that they were, on balance, a useful device that should be extended and enriched rather than abolished.

Sources

(1) ***Budget Statements 1982-83,*** Budget Paper No. 1 (Canberra: Australian Government Publishing Service, 1982)

(2) ***Report of the Public Inquiry into Income Tax Zone Allowances*** (Canberra: Australian Government Publishing Service, 1981)

(3) ***Personal Income Tax — Personal Allowances,*** Treasury Taxation Paper No. 7 (Canberra: Australian Government Publishing Serrvice, 1974)

(4) ***Taxation Review Committee, Full Report*** (Canberra: Australian Government Publishing Service, 1975)

Appendix C

Provincial Tax Credits

Several provinces now grant credits against provincial personal income taxes for municipal property taxes. Some are for homeowners only, some for renters only and some are for both. In addition, tax credits have been used for sales taxes, home heating costs and cost-of-living. The following is a brief summary of the tax credits:

1) Quebec

Quebec provides a refundable property tax credit for homeowners and tenants. The credit is calculated as 40 per cent of property taxes paid (where, in the case of renters, the property tax is related to the portion of the dwelling occupied) less 2 per cent of the household's taxable income. The maximum credit is $400.

2) Ontario

The Ontario Tax Credits consist of a property tax credit (for renters and homeowners), a sales tax credit and a temporary home heating credit.

The property tax credit is the lesser of $180 or the "occupancy cost" (calculated as property taxes paid or 20 per cent of rent) plus 10 per cent of the "occupancy cost" less 2 per cent of taxable income.

The sales tax credit is calculated as 1 per cent of personal exemptions less 2 per cent of taxable income.

The Ontario Temporary Home Heating Credit is $40 less 1 per cent of taxable income.

3) Manitoba

Manitoba has a property tax credit and a cost-of-living credit. The property tax credit to property taxpayers and renters may not exceed property taxes paid (for homeowners) or 20 per cent of rent for tenants). The maximum credit of $525 ($625 for seniors) is reduced by 1 per cent of "net family income". The general minimum payment is $325. This minimum appears on property tax statements whereas the income-related portion of the tax credit goes through the income tax system.

The refundable cost-of-living credit is equal to 3 per cent of personal exemptions less 1 per cent of net family income.

4) Saskatchewan

Homeowners receive a provincial income tax credit of up to $250. The minimum credit is $100.

5) Alberta

The Alberta Renter Assistance Tax Credit Program provides a credit against provincial personal income taxes of $80 plus 5 per cent of rent paid to a maximum of $250. This amount is reduced by 1 per cent of taxable income for a minimum credit of $50.

6) British Columbia

The rent Aid Tax Credit Program provides a credit equal to $150 less 1.5 per cent of taxable income. The benefit cannot exceed 10 per cent of rent paid in the previous year.

Appendix D

Statistical Appendix

1. Employment in the Northwest Territories, 1982
2. Government of the Northwest Territories: Sources of Revenue, 1981 and 1982
3. Government of the Northwest Territories: Expenditures by Function, 1981 an 1982
4. Maximum Taxable Low-Cost Housing Benefits in the Northwest Territories
5. Average Monthly Charges by Type of Unit, by Region, for GNWT Housing, 1982
6. Effects of "Caps" on Locational Advantage within NWT
7. Occupied Private Dwellings, by Tenure, in NWT in 1981
8. Federal Government Housing in the Northwest Territories, 1982
9. Effects of Differential Treatment of Cash and In-Kind Housing Allowances
10. Price Indexes, by Component, Yellowknife, June 1982
11. Tax Effects of Allowing for the Differential Cost of Living in the NWT, 1978
12. Effective Tax Rates in NWT and Manitoba, 1981
13. Proposed Tax Deductions Based on Living Cost Differentials, 1983

Table 1

Employment in the Northwest Territories, 1982

	Number	Percentage Distribution
Public Sector Employees:		
federal	2,650	17.2
federal enterprises	595	3.9
territorial	3,586	23.3
territorial enterprises	25	0.2
local	790	5.1
Private Sector Employees:		
mining, oil & gas	3,754	24.4
transportation & communication	1,434	9.3
service	535	3.5
trade	946	6.1
other	1,101	7.1
TOTAL	**15,416**	**100.0**

Source: Data as of end November 1982, compiled by GNWT Bureau of Statistics from Statistics Canada data.

Table 2

Government of the Northwest Territories:
Sources of Revenue, 1981 and 1982 ($,000)

	1981	1982
Own-Source Revenues		
Income tax	23,857	40,123
Fuel & other taxes	8,241	9,954
Liquor control system	7,398	8,304
Investment interest	5,221	11,377
Licenses and fees	2,022	2,366
Other	16,933	19,852
Subtotal	63,672	91,976
Transfers from Federal Government		
Operating grant	157,217	184,963
Capital grant	59,463	73,755
Small business loans & guarantees fund	541	-
Specific purpose transfers		
Health	16,138	18,606
Social services	8,480	9,163
Public Works	7,952	81
Education	5,157	4,726
Justice & public services	560	555
Other	845	1,465
Subtotal	256,353	293,314
Other Resources		
Projects for Canada & others	15,002	20,846
TOTAL REVENUES	**335,027**	**406,136**

Source: GNWT, 1982 Annual Report

Table 3

Government of the Northwest Territories:
Expenditures by Function, 1981 and 1982 ($,000)

	1981	1982
Operating		
Education	46,258	54,948
Public Works	43,373	47,949
Health	26,429	33,003
Local Government	20,799	25,747
NWT Housing Corporation	24,373	25,263
Social Services	22,187	23,762
Economic Development & Tourism	13,465	17,225
Justice & Public Services	12,911	15,973
Personnel	9,084	12,176
Highways	9,173	11,665
Other	29,020	35,563
	257,072	303,274
Capital	55,055	69,330
Other		
Projects for Canada & others	15,002	20,846
TOTAL	**327,129**	**393,450**

Source: GNWT, 1982 Annual Report.

Table 4

Maximum Taxable Low-Cost Housing Benefits in the Northwest Territories

	Yellowknife	Other Locations in NWT
"Common Shelter"	$125 per month including value of subsidized utilities	$75 per month including value of subsidized utilities
Apartment/Duplex	$350 per month excluding value of subsidized utilities	$225 per month excluding value of subsidized utilities
	$400 per month including value of subsidized utilities	$275 per month including value of subsidized utilities
House	$500 per month excluding value of subsidized utilities	$350 per month excluding value of subsidized utilities
	$650 per month including value of subsidized utilities	$450 per month including value of subsidized utilities

Table 5

Average Monthly Charges by Type of Unit, by Region, for GNWT Housing, 1982 (in dollars)

	Yellowknife	Fort Smith	Inuvik	Baffin	Keewatin
Row House	701.63	189.68	648.44	246.90	218.36
Apartment	644.03	592.95	585.23	124.50	144.04
Highrise	666.89	686.12	-	111.25	-
House without basement	737.28	232.81	375.57	195.70	205.18
House with basement	787.31	659.68	268.08	299.03	277.14
Mobile home	-	317.01	-	-	65.00
Multiplex with basement	-	333.31	319.69	233.17	251.00
Multiplex without basement	690.00	656.13	-	-	-

Notes: 1) The average rents are calculated for units paid by payroll deduction (as opposed to direct payment, lease to purchase, etc.) Payroll deductions are the most common form of payment for GNWT housing.
2) These numbers represent basic charges and exclude utilities.

Source: Unpublished data from GNWT.

Table 6

Effects of "Caps" on Locational Advantage within NWT

	Yellowknife	Other NWT
Market rent of house[a]	$1,000	$1,000
Actual rent paid[b]	0	0
"Subsidy" received[c]	1,000	1,000
Amount included in taxable income[d]	650	450
Increase in tax at 30% rate[e]	195	135
After-tax income	805	865

a) The cost of providing the house could of course be greater or less than this amount.
b) If any rent is paid, the amount would simply be deducted from the cap and only the difference included in taxable income.
c) "Subsidy" is in quotes because of the later argument in the text that it is arguable whether all of this amount is correctly considered a subsidy from a tax point of view.
d) Caps for house including subsidized utilities (from Table 4).
e) The precise rate used is immaterial to the point being illustrated.

Table 7

Occupied Private Dwellings, by Tenure, in NWT in 1981

	Dwellings	Owned	% Owned
Regions			
NWT	11,520	2,605	22.6
Baffin	1,700	70	4.1
Fort Smith	6,420	2,215	34.5
Inuvik	1,850	295	15.9
Keewatin	780	10	1.1
Kitikmeot	680	10	1.5
Selected Settlements			
Fort Simpson	255	90	35.3
Fort Smith	630	245	38.9
Hay River	890	345	38.8
Pine Point	510	110	21.6
Yellowknife	3,185	935	29.4
Inuvik	920	95	10.3

Source: 1981 Census

Table 8

Federal Government Housing in the Northwest Territories, 1982

	Detached Houses	Duplex	Row House	Apartments	Mobile Homes
Yellowknife	76(72)	26(26)	238(135)	156(77)	-
Inuvik	58(58)	262(262)	262(262)	129(69)	3(3)
Norman Wells	7(7)	24(24)	-	19(19)	-
Frobisher Bay	20(20)	-	62(38)	46(-)	-
Pine Point	10(10)	-	-	1(-)	1(1)
Fort Smith	27(27)	18(18)	11(11)	14(14)	-
	217	664		376	4(4)

Notes: (1) Numbers in parentheses are units owned by federal government.
(2) The figures in this table cover communities in which the federal Department of Public Works looks after housing. In other communities individual departments look after the housing requirements of their staff. Some federal departments, for example, lease housing from GNWT.

Source: GNWT Bureau of Statistics.

Table 9

Effects of Differential Treatment of Cash and In-Kind Housing Allowances

	Federal Employee	GNWT Employee	Federal/GNWT
Income from employment without benefits	$30,000	$30,000	1.00
Income from employment with benefits	42,000	35,400	1.19
Value of housing allowance	12,000	5,400	2.22
Amount of benefit added to income	5,400*	5,400	1.00
Taxable income including benefits	31,130	31,130	1.00
After-tax income with benefits	32,619	26,019	1.25
Cash portion of after-tax income w/benefits	20,619	26,019	.79
Housing payment	—	12,000	
Net Cash	20,619	14,019	1.47

After-tax income with benefits = Income from employment with benefits — Tax Payable.

* The value of taxable benefits from low-cost housing will be calculated as the lesser of a maximum dollar limit or 20% of income from employment less the rent actually paid.

(25,000 x 20%) - 0 = $5,000
(30,000 x 20%) - 0 = $6,000 maximum 450/mth = 5,400**
(35,000 x 20%) - 0 = $7,000 maximum 450/mth = 5,400**

** Assuming the Employee lives outside Yellowknife in a house which includes subsidized utilities.

NOTE: The deductions made from employment income in arriving at taxable income include —
Personal Exemption $3,770
Employment Expense Deduction $500

Table 10

Price Indexes, by Component
Yellowknife, June 1982 (Edmonton = 100)

Food	125.0
Housing	150.5
Clothing	115.3
Transportation	116.7
Health and Personal Care	118.0
Recreation, Reading & Education	115.7
Tobacco and Alcohol	119.4
All Items	128.1

Source: GNWT Spatial Price Survey, Yellowknife-Edmonton, June 1982 (Yellowknife: Bureau of Statistics, 1982)

Table 11

The Effect of Allowing for the Differential Cost of Living in the Northwest Territories for a Taxpayer, Married with Two Dependents 1978

Gross Income	Taxable Income		Federal Tax Payable	
	Unadjusted	Indexed for Northern Cost of Living	Unadjusted	Indexed for Northern Cost of Living
$	$	$	$	$
12,500	6,168.60	3,253.60	605.06	16.17
19,000	12,343.60	9,428.60	1,906.22	1,140.88
25,000	18,043.60	15,128.60	3,307.52	2,298.33
40,000	32,293.60	29,378.60	7,338.22	5,601.01

Source: Calculated using the 1978 Individual Income Tax Return. The indexation for northern costs involved indexing personal exemptions standard deduction, employment expense deduction and tax brackets by 150 percent.

Note: The Taxpayer is assumed to take the married or equivalent exemption and have two dependent children under 16 years of age. It is assumed family allowance of $240 p.a. per child is received: that RPP is 5 percent of gross income, CPP is $169.20 and UIC is $187.20.

Source: James M. Dean, "The Interaction of Federal and Territorial Income Tax Rates: The Case of the Northwest Territories" (Paper presented to the Canadian Regional Science Association, Halifax, May 1981).

Table 12

Effective Tax Rates in NWT and Manitoba, 1981

	NWT	Manitoba
Unadjusted Taxable Income	10,000	10,000
Federal Tax at 14%	1,400	1,400
Provincial/Territorial Tax[a]	602	746
After-tax Income	7,998	7,844
Adjusted Taxable Income[b]	6,667	10,000
Adjusted After-tax Income	5,332	7,844
Effective federal tax rate	21%	14%
Effective prov./territorial rate	9.0%	7.5%

Notes: (a) At 43% of federal for NWT and 54% for Manitoba
(b) NWT cost-of-living assumed to be 150% of Canadian average.

Table 13

Proposed Tax Deductions Based on Living Cost Differentials by Community, 1983

Region	Base City	Base Figure	Index	Extension	Proposed Differential Deduction
Inuvik					
Aklavik	Edmonton	10,971	140-149	16,347	5,500
Arctic Red River	Edmonton	10,971	150-159	17,444	6,500
Colville Lake	Edmonton	10,971	160-169	18,541	7,500
Fort Franklin	Edmonton	10,971	150-159	17,444	6,500
Fort Good Hope	Edmonton	10,971	150-159	17,444	6,500
Fort McPherson	Edmonton	10,971	150-159	17,444	6,500
Fort Norman	Edmonton	10,971	140-149	16,347	5,500
Inuvik	Edmonton	10,971	130-139	15,250	4,000
Norman Wells	Edmonton	10,971	140-149	16,347	5,500
Paulatuk	Edmonton	10,971	160-169	18,541	7,500
Sachs Harbour	Edmonton	10,971	170-179	19,639	8,500
Tuktoyaktuk	Edmonton	10,971	150-159	17,444	6,500
Fort Smith					
Buffalo Junction	Edmonton	10,971	120-129	14,153	3,000
Enterprise	Edmonton	10,971	120-129	14,153	3,000
Fort Liard	Vancouver	10,818	130-139	15,037	4,000
Fort Providence	Edmonton	10,971	130-139	15,250	4,000
Fort Resolution	Edmonton	10,971	130-139	15,250	4,000
Fort Simpson	Edmonton	10,971	120-129	14,153	3,000
Fort Smith	Edmonton	10,971	120-129	14,153	3,000
Hay River	Edmonton	10,971	120-129	14,153	3,000
Jean Marie River	Edmonton	10,971	140-149	16,347	5,500
Lac La Martre	Edmonton	10,971	150-159	17,444	6,500
Nahanni Butte	Edmonton	10,971	140-149	16,347	5,500
Pine Point	Edmonton	10,971	120-129	14,153	3,000
Rae Edzo	Edmonton	10,971	130-139	15,250	4,000
Rae Lakes	Edmonton	10,971	150-159	17,444	6,500
Snare lake	Edmonton	10,971	150-159	17,444	6,500
Snowdrift	Edmonton	10,971	150-159	17,444	6,500
Trout Lake	Edmonton	10,971	150-159	17,444	6,500
Tungsten	Vancouver	10,818	110-119	12,873	2,000
Wrigley	Edmonton	10,971	140-149	16,347	5,500
Yellowknife	Edmonton	10,971	120-129	14,153	3,000

Table 13

Part 2

Region	Base City	Base Figure	Index	Extension	Proposed Differential Deduction
Baffin					
Arctic Bay	Montreal	11,497	170-179	20,580	9,000
Broughton Island	Montreal	11,497	170-179	20,580	9,000
Cape Dorset	Montreal	11,497	160-169	19,493	8,000
Clyde River	Montreal	11,497	180-189	20,695	9,000
Frobisher Bay	Montreal	11,497	160-169	19,493	8,000
Grise Fiord	Montreal	11,497	190-199	22,879	11,000
Hall Beach	Montreal	11,497	160-169	19,493	8,000
Igloolik	Montreal	11,497	160-169	19,493	8,000
Lake Harbour	Montreal	11,497	170-179	20,580	9,000
Nanisivik	Montreal	11,497	160-169	19,493	8,000
Pangnirtung	Montreal	11,497	170-179	20,580	9,000
Pond Inlet	Montreal	11,497	180-189	20,695	9,000
Resolute Bay	Montreal	11,497	160-169	19,493	8,000
Sanikiluaq	Montreal	11,497	150-159	18,280	7,000
Keewatin					
Baker Lake	Winnipeg	10,195	160-169	17,230	7,000
Chesterfield Inlet	Winnipeg	10,195	160-169	17,230	7,000
Coral Harbour	Winnipeg	10,195	160-169	17,230	7,000
Eskimo Point	Winnipeg	10,195	140-149	15,191	5,000
Rankin Inlet	Winnipeg	10,195	150-159	16,210	6,000
Repulse Bay	Winnipeg	10,195	170-179	18,249	8,000
Whale Cove	Winnipeg	10,195	150-159	16,210	6,000
Central Arctic					
Cambridge Bay	Edmonton	10,971	150-159	17,444	6,500
Coppermine	Edmonton	10,971	150-159	17,444	6,500
Gjoa Haven	Edmonton	10,971	170-179	19,638	8,500
Holman Island	Edmonton	10,971	170-179	19,638	8,500
Pelly Bay	Edmonton	10,971	200-209	22,929	12,000
Spence Bay	Edmonton	10,971	170-179	19,638	8,500

Note: Based on average non-housing costs for households with two or more persons.

Source: GNWT "Proposal for Regionally Varying Tax Deductions" D.O.F. April 22, 1982.

Notes:

1. "Alternatives to the Moratorium on Taxation of Northern Allowances" (mimeo.; Yellowknife, Government of the Northwest Territories, August 1982).

2. The benefits received by the approximately 3,600 employees of the territorial government are summarized in Appendix A to the present study.

3. "Housing and Travel Benefits in the North and Isolated Posts" (mimeo.; Government of Canada, December 2, 1982), p. 1. The full quotation actually makes the main point of the present paper very nicely: "...it is the government's aim to establish fairness in taxation by placing residents of Northern and isolated posts on a tax footing comparable with that affecting other Canadians." Even if "fairness" were the sole objective of policy — in which case this area of taxation would be unique — the proposed scheme clearly does not achieve this aim, as shown in the present study.

4. By way of comparison, Prince Edward Island derived 53% of its revenues in 1980-81 from federal cash transfers while Newfoundland derived 48% of its revenues from the same source (calculated from Canadian Tax Foundation, ***Provincial and Municipal Finances 1981*** (Toronto, 1981), p. 44).

5. This argument is well-stated in James M. Dean, "The Interaction of Federal and Territorial Income Tax Rates: The Case of the Northwest Territories", (Paper presented to the Canadian Regional Science Association, Halifax, May 1981). As Dean shows, and is discussed later in the present study, the common federal critique that the NWT has "low" taxes (both because of its low income tax rates and its lack of a retail sales tax) is fundamentally misconceived, ignoring as it does the basic reality that a dollar in the NWT is ***not*** equivalent to a dollar elsewhere in Canada.

6. The following brief account draws heavily on ***Constitutional Development in the Northwest Territories, Report of the Special Representative*** (January 1980), Chapter 6.

7. This account is based largely on a GNWT summary entitled, "Formula Based Financing" (November 20, 1980).

8. Calculated from data in Canadian Tax Foundation, ***Provincial and Municipal Finances 1981*** (Toronto, 1981).

9. An excellent example of a well-functioning, albeit complex, system which does take adequate account of regional cost differences in determining transfers is in Australia, where the special problems of the Northern Territory (recently made a state) have long been taken explicitly into account. For a recent account of the Australian system, see Russell Mathews, "Regional Disparities and Fiscal Equalization in Australia," in Mathews, ed., ***Regional Disparities and Economic Development*** (Canberra: Centre for Research on Federal Financial Relations, The Australian National University, 1981).

10. As the Government of Ontario has long known, it is hardly necessary to go to the lengths of Australian complexity to recognize the special expenditure needs of the North: some Ontario granting formulas simply provide a special additional allowance for northern municipalities in

crude recognition of the higher costs they face (see R. M. Bird and N. E. Slack, ***Residential Property Tax Relief in Ontario*** (Toronto: University of Toronto Press, 1978), pp. 125-26).

11. The Income Tax Act (ITA) is perhaps not quite as clear on this matter as Revenue Canada's Interpretation Bulletin No. IT-470, "Employee's Fringe Benefits — After 1980", (or its predecessor IT-71R), makes it sound. Although S.6(1)(a) of the ITA ***does*** explicitly include in income from employment "the value of board, lodging and other benefits", it also specifies that such benefits must be "received or enjoyed", by the employee. Not only some past cases — e.g., in several instances hotel employees required to occupy accommodation provided by their employers have been successful in overturning assessments — but also some of the explicit exclusions in the same Interpretation Bulletin — transportation to the job, subsidized school services in remote areas, moving expenses — might perhaps be interpreted as recognizing that employees should ***not*** be taxed for benefits that primarily constitute an advantage to the employer, acceptance of which is, in effect, a necessary aspect of the employee's working conditions. The degree of benefit "received or enjoyed" in some cases from northern benefits might perhaps be argued on these grounds. The remote worker-exclusion in S.6(6) is in a sense an instance of this principle being applied. This exclusion was actually ***extended*** in Bill C-139 recently to include employees who had no dependents to be maintained in their place of ordinary residence.

    Since the S.6(6) exemption is limited to employment periods of less than two years in duration, however, it is of little use to permanent northern residents. Apart from possible legal arguments, therefore, an alternative attack on the recent directive might be based perhaps on the strange, and apparantly conflicting, policy objectives being sought when on the one hand "fly-in, fly-out" work in remote areas — such as most of the NWT — is specifically favoured through provisions such as S.6(6), while at the same time what is in effect a tax penalty (although in law perhaps only a removal of a tax favour) is being levied on those who have chosen to make their permanent homes in the North. Both of these approaches are developed a little further later in this study.

12. "Isolated Posts Benefits and Allowances Remission Order" (Order in Council PC 1980-1717, June 26, 1980; as amended by PC 1980-2948, October 30, 1980, and PC 1983-299, February 3, 1983).

13. Starting in 1982, however, "reasonable travelling expenses" incurred by residents in isolated areas (presumably including all the NWT) to obtain medical services not available in their region will qualify as a deductible medical expense. Such costs may therefore be deducted from taxable income to the extent to which they exceed 3% of net income.

14. Although throughout this paper the discussion focuses entirely on the NWT, presumably everything said can be extended to the Yukon.

15. "Housing and Travel Benefits," p. 2.

16. Current GNWT housing policy is to charge market rents in Yellowknife, Fort Smith, Fort Resolution, Pine Point, Hay River, Fort Providence, Inuvik, and Fort Simpson. By November 1984 it is intended that staff accommodation in these places will no longer be provided by the GNWT. All employees receive a Standard Housing Allowance ($5,400 per year) in these market rate communities. Staff accommodation will continue to be provided in other communities, however.

    Market rents for houses are calculated on the basis of appraised values. For apartments, market rents are determined by market rents for other units.

    With respect to utility charges for houses, all utilities are paid by the tenant in Yellowknife and Fort Smith. In Fort Simpson, Hay River and Pine Point, an electricity fee is charged by the GNWT; the remainder is paid by the tenant. All utilities are extra in Fort Resolution and Inuvik.

    For apartments, market rents include electricity if the apartment is not individually metered. Otherwise, electricity is paid by the tenant. Fuel and water are included in the rents, however.

17. Two possible caveats to this argument may be noted. In the first place, the tax system as a whole already provides a strong inducement to home ownership in the North, as elsewhere, so it might perhaps be argued that creating some favouritism to renters may be ***more,*** rather than less, efficient and equitable. The answers to this

comment are (1) that if this is a good idea, there seems no reason to confine it to the North, and (2) that it is in any case inconsistent with Canada's apparent development policy in the North since it provides additional encouragement to transient population.

A second possible caveat is quite different. The federal government may perhaps be interested in deliberately ***discouraging*** homeownership, particularly in remote areas. Among those affected by the new scheme, for example, are employees of mining and resource companies. It might be that the last thing the government wants to do at the present time is to encourage in any way the establishment of permanent "single-industry" communities in remote locations which may, at some later date when the resource is worked out or world price trends are adverse, require a public sector "bail-out". This possible concern needs to be balanced against the possible desire to establish a permanent "government" presence in the north: since neither side of this proposition lends itself to a precise economic calculus, however, these matters are not further developed here.

18. This provision should perhaps be related to the "remote worksite exclusion" discussed in note 11 above. For example, a resident of Yellowknife working in a "remote" worksite in the NWT and living in subsidized accommodation in Yellowknife, while probably still better off from a strictly tax point of view than his fellow worker living in Edmonton, has clearly lost some relative advantage as a result of the proposal. (There are also obviously further advantages to bunkhouse employees in failing under S.6(6) — see note 11 — rather than the new "cap" system, which reinforces the tax bias in favour of transitory employment.)

19. See note 16 above. Other information from GNWT Bureau of Statistics.

20. As noted earlier, the "cap" system in effect has the same result to some extent, at least for those employees who receive in-kind housing subsidies.

21. In the case of the GNWT, for example, typically only about 20% of new employees are southern recruits although this proportion rises to 65% for teachers. (Information from GNWT Personnel Department.)

22. Calculated from GNWT, Bureau of Statistics, ***Spatial Price Survey, Yellowknife-Edmonton, June 1982,*** (1982), p. 7. The relationship between NWT prices as a whole and the Canadian CPI may of course be quite different, but the point is the same: why should the latter control the value of a ***regionally***-differentiated tax provision? (A possible answer for travel was noted earlier in the text, but that rationale applied only to air travel, or, defined as broadly as possible, to inter-city public transportation — which constitutes less than 10% of the Yellowknife transportation index, for example.)

23. "Alternatives to the Moratorium on Taxation of Northern Allowances", p. 18. See also Table 1 in the Statistical Appendix.

24. The perverse incentives of the new tax system in this respect are particularly curious in view of the strong support in the Drury report for territorial policy in this respect, including the recommendation that the federal government too should move to a cash allowance for housing ***(Constitutional Development,*** p. 105).

25. A minor point in this respect is that to some extent companies may be justified in efficiency terms in "tying" employees who have acquired, at company expense, marketable skills, to them in this way: a similar argument is sometimes made with respect to pensions.

26. See HDD Resource Consultants Ltd., ***A Study of Employee Benefits Provided by Mining Operations in the Yukon and Northwest Territories*** (June 1982). Housing benefits in this study were calculated as the difference between the cost to the employer to provide housing and any rents received from employees: to the extent this cost exceeds "market" value, this procedure overestimates the effects of full taxability of benefits. The limits established in the new system of course make the degree of overestimation even larger.

27. The lack of discussion of the self-employed with respect to this whole issue is striking. The main rationale for this neglect is probably the view that this group (which is quite small in the NWT, accounting for only about 2% of income) is able to look after itself. It might seem more in line with Northern development objectives — e.g., on housing — to remove completely the discrimination between employees and self-

employed. The full taxation of benefits could of course achieve this objective (subject to the caveats on measurement noted elsewhere) but, as argued later, a stronger case can actually be made for taking precisely the opposite tact, and extending some tax benefits to ***all*** NWT residents regardless of their employment status. The parallel in some respects between the employed/self-employed situation and the owner-tenant argument sketched in note 17 above is strong: in both cases one group (self-employed, owners) is favored by Canadian tax law in general but in the North the effects of this favoritism were muted by special concessions to the other group (employees, tenants). The proposed new system moves the North back to the general Canadian norm and claims it is doing so in the name of improved "tax-payer equity". While no conclusive answers can be reached on this matter — it depends both on the numbers of people involved and the weights to be attached to the well-being of different groups — it is far from clear that any equity argument can justify this change in an imperfect, "second-best" world.

28. James M. Dean, "Tax-induced Migration in Canada 1972-79", ***Western Economic Review,*** 1 (No. 2), 17-31. Unfortunately, NWT data are not distinguished in this study — or, it appears, in any other extant Canadian study. A recent elaborate Economic Council study also supports strongly the case for fiscally-induced migration: see Stanley L. Winer and Denis Gauthier, ***Internal Migration and Fiscal Structure*** (Ottawa, 1982).

29. Whether or not there is induced migration — or non-migration — its implications for economic efficiency are quite another, and even less well-understood, matter as shown, for example, in the recent prolonged (and inconclusive) discussion by various authors in ***Canadian Public Policy/Analyse de Politiques,*** 7 (Nos. 3 and 4), 283-310, 621-32.

30. Information from DIAND.

31. Obviously, it is primarily the non-native population that is under discussion here. If, on the other hand, it is desired to ***discourage*** permanent settlement of non-natives in the North, the proposed policy change may make more sense. The (longer-term) developmental vision implicit in this tax policy might be, in effect, to use Southern experts on a short-term, visiting basis while (in effect) restricting permanent employment to existing (non-mobile) residents. Of course, if development slows down as a result, wage levels may turn out to be lower. In any case, it seems most unlikely that fiddling with the tax system is a good way to achieve such policy aims, even if anyone had them in mind in designing tax policy, which seems unlikely.

32. See, for example, R.W. Boadway and H.M. Kitchen, ***Canadian Tax Policy*** (Toronto: Canadian Tax Foundation, 1980), p. 80; V. Salyzyn, ***Canadian Income Tax Policy***)2nd ed.; Toronto: CCH Canadian Ltd., 1981), p. 70.

33. ***Report of the Royal Commission on Taxation*** (6 vols.; Ottawa: Queen's Printer, 1966), vol. 3, p. 298.

34. For a particularly clear recent statement of this position, see B. L. Ferguson, "Income Tax Treatment of Employee Fringe Benefits," National Tax Association — Tax Institute of America, ***Proceedings of the 74th Annual Conference on Taxation*** (Columbus, 1981), pp. 86-92.

35. See, for example, D. J. Sherbaniuk, ***Specific Types of Personal Income*** (Studies of the Royal Commission on Taxation, No. 16, Ottawa, 1967), p. 115, and R. W. Pound, "Fringe Benefits: Management Perks," ***1979 Corporate Management Tax Conference*** Toronto: Canadian Tax Foundation, 1979), 71.

36. Broadway and Kitchen, ***op. cit.,*** p. 81; Salyzyn, ***op. cit.,*** p. 70.

37. See various examples in Revenue Canada Taxation, Interpretation Bulletin IT-470.

38. U.S. Internal Revenue Code (IRC) section 119 and Treasury Regulations section 1.119-1.

39. "Discussion Draft of Proposed IRRS Regulations on Employee Fringe Benefits," ***Federal Register,*** 40 (September 5, 1975), 4118.

40. See also the discussion in note 11 above.

41. ***Finance Act 1971,*** Section 33(4).

42. Income Tax Assessment Act, Section 26AAAA.

43. For a recent thorough discussion, see ***Report of the Public Inquiry into Income Tax Zone Allowances*** (Canberra: Australian Government Publishing Service, 1981). The U.S. Constitution (Article I, section 8) precludes regionally-differentiated taxes in that country and the issue has apparently never arisen in the U.K.

44. In Henry Simons' classic ***Personal Income Taxation*** (Chicago: University of Chicago Press, 1938) — the fount of much of "comprehensive tax base" wisdom — after discussing the case of the adjutant who gets to go to all the operas free but hates opera he notes that fortunately "such difficulties in satisfactory measurement of relative incomes do not bulk large in modern times" (p. 53). Unfortunately, they still bulk quite large for some people, including, it is suggested here, most northern residents.

    Similarly, the easy assurance of Simons that "elements of unmeasurable psychic income may be presumed to vary in a somewhat continuous manner along the income scale" (p. 53) is of little use in assessing horizontal equity problems. For example, climate differentials have been argued to be offset in part by income differentials (Philip E. Graves, "Migration and Climate," ***Journal of Regional Science,*** 20 (No. 2, 1980), 227-37): two people in precisely identical utility positions may thus have quite different money (and in-kind) compensation. A spatially-uniform progressive tax system will tax the person in the area with a less pleasant climate — and consequently a higher compensatory income — more heavily and will therefore in a sense be horizontally inequitable. Arguments based on "psychic" income or its lack are always tricky, however, and the subsequent argument for regional differentials is in no sense based on individual tastes or preferences.

45. ***Budget Papers, Supplementary Information and Notices of Ways and Means Motions on the Budget*** (November 12, 1981), p. 19. (Incidentally, the subsequent allusion in the quoted passage to small business is a complete red herring.)

46. This problem does not arise under a proportional rate structure. If for example, all individuals face a 25% marginal tax rate, an individual with a gross taxable income of $10,000 in the South compared to $15,000 in the North (where the cost of living is, say, 50% higher) would face taxes of $2,500 compared to $3,750. The disposable income in the South would than be $7,500 and in the North, $11,250. In real terms, both taxpayers are left equally well off since the differential in after-tax income ($3,750) reflects the differential cost of living. Both individuals thus achieve a comparable living standard. (This example is taken from one in Dean, "Interaction of Federal and Territorial Income Tax Rates", pp. 6, 9.)

47. Continuing the example of the previous note, suppose the average tax rate on a taxable income of $15,000 is now 30%. The after-tax income in the South would still be $7,500, but that in the North would now be reduced to $10,000 — an amount equivalent, given the assumed cost-of-living differential, to only $6,667 in "Southern" dollars. To restore equality, pre-tax income in the North would need to be equal to after-tax income in the South grossed up by the difference in average tax rates divided by the cost-of-living differential, or in this example, to $16,071 (assuming that this further gross-up did not further raise the effective tax rate).

48. See J. R. Allan, D. A. Dodge, and S. N. Poddar, "Indexing the Personal Income Tax: A Federal Perspective", ***Canadian Tax Journal***, 22 (No. 4, 1974), 355-69, for a clear statement of the equity case for temporal indexing of the personal income tax.

49. For example, because the overall cost-of-living differentials among Canadian cities are not too great, because federal-provincial equalization transfers may, in part, explicitly offset such regional differences, or perhaps because there are no explicit policy reasons to alter market adjustment to such differentials. In the case of the NWT, however, as argued here, none of these factors holds.

50. GNWT, ***Spatial Price Survey***, (Yellowknife: Bureau of Statistics, 1982).

51. For further discussion of regional price variations in Canada, see M. Denny and M. Fuss, "Regional Price Indexes: The Canadian Practice and Some Potential Extensions" (Paper Prepared for the Statistics Canada Conference on Price Measurement, Ottawa, November 1982). In 1979, for example, Statistics Canada data reported in this source shows that the

range of cost-of-living variation among 12 Canadian cities was less than 7% with Quebec City being the lowest and St. John's the highest. Excluding St. John's, the variation was less than 1%! Although Winnipeg and Edmonton were the most expensive cities, on the whole there was no significant difference in total CPI among these different Southern cities (although there was, of course, much more variation in such widely-publicized categories as housing).

52. These figures come from the Drury Report (p. 113), and refer to the cost-of-living allowances paid to federal employees in the NWT. The Pay Research Bureau carries out periodic special studies to determine these allowances, but these data were not available to us.

53. While a more comprehensive comparison is not needed to make the point, it seems unlikely that many, if any, taxpayers at any income level, anywhere in the country, were subjected to higher effective provincial taxes on real income than fell to the lot of NWT residents.

54. For an extended discussion of this and related arguments, see R. M. Bird, "Federal Finance and Economic Union," Paper presented at the Canadian Economics Association, Vancouver, June 3, 1983.

55. See J. M. Buchanan, "Federalism and Fiscal Equity", ***American Economic Review,*** 40 (Sept. 1950), where this case is made in detail. (For a quite different argument leading to a very similar conclusion, see R. M. Bird, "Personal Income Tax Differentials in an Open Economy" (February 1983).

56. See Bird, "Federal Finance and Economic Union", for an introduction to some of these lines of argument.

57. If the market rent were less than $500 (or whatever figure is established), presumably that lower figure would be the "cap". The present 20% of income limit could also be retained, if desired, to provide further protection for low-income people.

58. Continuing the illustration in the text, if the rent charged the employee was $500, there would be no taxable benefit. However, if it were only $300, there would be a taxable benefit of $200 — regardless of either the "market rent" or the cost of providing the housing in question.

59. Obviously, it is not appropriate here to go into the many aspects of inflation adjustment, particularly with respect to capital income, that do not have close analogues when viewed spatially (assuming national capital markets function at all).

60. See GNWT Position Paper on the Issue of the Taxation of Northern Allowances and Isolated Post Benefits and Allowances (Sept. 1980).

61. See E. Slack, "Provincial-Municipal Grant Reform in Ontario", in J. Bossons, et al., ***Municipal Fiscal Reform in Ontario*** (Toronto, 1981). Since the proposed grant is based on expenditure requirements and the empirical evidence only applies to transfers based on fiscal capacity, the impact may not be quite the same, however. There may be some incentive, for example, to increased expenditures to increase the grant (since presumably the formula would provide for increased grant funds as expenditures increased). If expenditures rise for this or other reasons, taxes may not fall by as much as would be predicted for grants based on fiscal capacity.

62. Such a grant could perhaps — by stretching matters a bit — be viewed as a sort of "revenue guarantee" provision, with the federal grant to the GNWT in effect making up for the territorial revenue foregone through the tax credit. On the other hand, this approach obviously works against any policy objective of increasing local fiscal autonomy in the North.

63. See the Australian scheme described in Appendix B for a system of this sort; the major difference is that Australia has since 1975 used, we think inappropriately, a credit rather than a deduction to deal with what is really a problem of the appropriate measurement of the tax base.

POOR

QUALITY

ORIGINAL